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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1935.

No. 41

GENERAL UTILITIES AND OPERATING COMPANY, PETITIONER,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

PETITION FOR CERTIORARI FILED MAY 3, 1935.

CERTIORARI GRANTED JUNE 3, 1935.

SUPREME COURT OF THE UNITED STATES

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[fol. 1]

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 52770

GENERAL UTILITIES AND OPERATING Co., Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Appearances:

For Taxpayer: R. Kemp Slaughter, Esq., Hugh C. Bickford, Esq., Jos. Slattery, Esq.
For Comm'r: Paul Waring, Esq., Wm. E. Davis, Esq.

DOCKET ENTRIES

Transferred to Mr. Arundell 1/6/34

1931.
Feb. 12. Petition received and filed. Taxpayer notified. (Fee paid.)
" 12. Copy of petition served on General Counsel.
Mar. 10. Answer filed by General Counsel.
" 13. Copy of answer served on taxpayer. General Calendar.

1932.
Aug. 9. Hearing set Oct. 5, 1932.
Sep. 20. Motion to consolidate with dockets 50510-11-12 and 50249, and for hearing 10/5/32, filed by General Counsel.
" 23. Hearing set Sept. 28, 1932, on motion.
Sep. 28. Hearing had before Mr. Arundel on motion to consolidate—withdrawn. To remain on Day Calendar of Oct. 5, 1932.

[fol. 2] 1932.
Sep. 28. Order granting respondent leave to withdraw motion to consolidate this proceeding to remain on Day Calendar of Oct. 5, 1932, to be heard on merits, entered.

1932.

Oct. 5. Hearing had before Mr. Arundell on merits. Submitted. Stipulation of facts filed. Briefs due in 15 days. Respondent's reply in 15 days.

" 12. Transcript of hearing of 10/5/32 filed.

" 18. Brief filed by taxpayer. 10/21/32, copy served on General Counsel.

" 31. Brief filed by General Counsel.

Nov. 10. Motion for extension to 11/19/32 to file reply brief filed by taxpayer. Granted.

" 17. Reply brief filed by taxpayer. 11/21/32, copy served on General Counsel.

1933.

Apr. 24. Findings of fact and opinion rendered, C. R. Arundell, Div. 7. Decision will be entered for the petitioner.

" 27. Decision entered C. R. Arundell, Div. 7.

May 17. Motion that Board reconsider decision filed by General Counsel.

" 26. Order denying motion that Board reconsider decision and that report and determination be recalled and the proceeding referred to Div. 4 for consideration and report and decision based on report of April 27, 1933, be vacated entered.

1934.

Jan. 30. Findings of fact and opinion rendered, C. Rogers Arundell, Div. 7. Decision will be entered for the petitioner.

Feb. 2. Decision entered, C. R. Arundell, Div. 7.

Apr. 23. Petition for review by U. S. Circuit Court of Appeals (4), with assignments of error, filed by General Counsel.

" 27. Proof of service filed by General Counsel. (2)

Jun. 15. Præcipe filed—proof of service thereon.

" 19. Order enlarging time to July 31, 1934, for transmission and delivery of record entered.

[fol. 3] BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

PETITION—Filed Feb. 12, 1931

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commis-

sioner of Internal Revenue in his notice of deficiency (IT:AR:C 8-DBH-60D) dated December 16, 1930, and as a basis of his proceeding alleges as follows:

1. The petitioner is a corporation organized under the laws of the State of Maryland with its principal office at 1310 Standard Oil Building, Baltimore, Maryland.

2. The notice of deficiency, a copy of which is attached and marked "Exhibit A" was mailed to the petitioner on December 16, 1930.

3. The taxes in controversy are income taxes for the calendar year 1928 in the amount of to-wit $128,342.07.

4. The determination of tax set forth in the said notice of deficiency is based upon the following error:

The Commissioner of Internal Revenue has erroneously held that the petitioner corporation made a profit of $1,069,517.25 by distributing to its own stockholders certain capital stock of another corporation which it had theretofore owned.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) Some time prior to 1928 the petitioner, General Utilities and Operating Company, acquired as bonus stock [fol. 4] and at no cost to it, twenty thousand (20,000) shares of the common capital stock of another corporation, the Islands Edison Company. This stock was placed upon its books at a nominal value of Two Thousand Dollars ($2,000.00). On March 22, 1928, the petitioner, by proper resolution of its Board of Directors, directed that Nineteen Thousand and Ten (19,010) shares of such capital stock should be distributed to its own stockholders in the ratio of two shares of such stock to each share of the common stock of the petitioner corporation.

(b) The shares of common stock were appreciated on the books of the General Utilities and Operating Company to a total value of $1,120,500 and by simultaneous entry were thereupon distributed to the stockholders in accordance with the aforementioned resolution of the Board of Directors on March 22, 1928. The certificate or certificates of said common stock of the Islands Edison Company were

actually transferred to the individual stockholders and were by them transferred on the books of the Islands Edison Company and new shares issued to the individuals who thereafter were the proper owners of said common capital stock.

(c) The Commissioner of Internal Revenue in preparing the aforementioned notice of deficiency held that the petitioner corporation derived a profit of $1,069,517.25 from such appreciation and distribution and added such amount to the taxable net income of petitioner, which action resulted in the deficiency hereby appealed from.

Wherefore petitioner respectfully prays that this Board may hear the proceedings and determine

1. That the petitioner corporation made no profit from the appreciation of the aforesaid common capital stock of the Islands Edison Company and the distribution of the stock to its own stockholders.

2. That there is no deficiency due by petitioner.

R. Kemp Slaughter, Hugh C. Bickford, Counsel for Petitioner.

[fol. 5] *Duly sworn to by H. P Lucas. Jurat omitted in printing.*

EXHIBIT "A" TO PETITION

IT:AR:C-8 DBH-60D

Mailed Dec. 16, 1930

General Utilities and Operating Company, 1310 Standard Oil Building, Baltimore, Maryland.

SIRS:

You are advised that the determination of your tax liability for the year 1928 discloses a deficiency of $128,342.07 as shown in the statement attached.

In accordance with section 272 of the Revenue Act of 1928, notice is hereby given of the deficiency mentioned. Within sixty days (not counting Sunday as the sixtieth

day) from the date of the mailing of this letter, you may petition the United States Board of Tax Appeals for a redetermination of your tax liability.

However, if you do not desire to petition, you are requested to execute the enclosed agreement form and for- [fol. 6] ward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this agreement will expedite the closing of your return by permitting an early assessment of any deficiency and preventing the accumulation of interest charges, since the interest period terminates thirty days after filing the enclosed agreement, or on the date assessment is made, whichever is earlier; whereas if no agreement is filed, interest will accumulate to the date of assessment of the deficiency.

Respectfully, David Burnet, Commissioner, by (Signed) W. T. Sherwood, Acting Deputy Commissioner.

Enclosures: Statement, Form 882, Form 870, Schedules 1 to 3, inclusive.

HT-3.

Statement

IT:AR:C-8 DBH-60D

Returns Examined

Company	Year	Form
General Utilities and Operating Company, 1310 Standard Oil Building, Baltimore, Maryland	1928	1120

Tax Liability

General Utilities and Operating Company

Year	Corrected tax liability	Tax previously assessed	Deficiency
1928	$132,023.89	$3,681.82	$128,342.07

[fol. 7] The revenue agent's report covering the year 1928 has been considered in this examination and has been accepted as submitted.

Careful consideration has been given to the contentions raised in your protest to the revenue agent in charge at Baltimore, Maryland, dated May 7, 1930; your protest dated October 27, 1930, and at a conference in Washington, D. C., on November 18, 1930. However, this office finds no basis for a revision of its findings as set forth in Bureau letter of October 7, 1930. See Schedule 2(a).

A carbon of this letter has been mailed to Messrs. Slaughter and Bickford, 815 Fifteenth Street, N. W., Washington, D. C., in accordance with the authority contained in a power of attorney running to them, which is on file in this office.

General Utilities and Operating Company

Year Ended December 31, 1928

Schedule 1

Net Income

Net income as disclosed by return	$30,681.83
As corrected	1,100,199.08
Adjustment	$1,069,517.25

Unallowable deductions and additional income:

(a) Profit realized on stock distributed as a dividend	$1,069,517.25	
Net adjustment as above		$1,069,517.25

Schedule 2

Explanation of Items Changed

(a) On March 22, 1928, the Board of Directors of your company passed a resolution providing:

[fol. 8] "(a) That this company appreciate on its books its holdings of common stock of The Islands Edison Company in the amount of 20,000 shares, in the amount of $1,120,500.00, and that the amount of this appreciation be credited to surplus arising from appreciation of assets."

"(b) That a dividend of $1,071,426.25, be, and it is hereby declared on the common stock of this company, payable in

common stock of The Islands Edison Company, at a valuation of $56.125, a share out of the surplus arising from appreciation, xxx."

This office after careful consideration of the above resolution is of the opinion that it created an obligation on the part of the corporation to pay to its stockholders $1,071,426.25, or its equivalent, and that the liquidation of this obligation by the payment of stock costing $0.10 a share, and having a market value of $56.125, resulted in the realization of profit to the corporation of the difference between the cost and market value, or $56.025 a share for the reason that the satisfaction of the obligation by the distribution of the stock was in effect a sale of the stock and a distribution of the proceeds. Your attention is invited to the decision by the United States Board of Tax Appeals in the case of the Bacon-McMillan Veneer Company v. Commissioner of Internal Revenue, 20 B. T. A., which held substantially as stated above in your case, and added,

"If the resolution had merely provided that the Liberty Bonds should be distributed by way of dividends, a different situation would have been presented which is clearly distinguishable from the case we have before us. In our opinion the petitioner realized taxable gain when the Liberty Bonds were distributed in satisfaction of the dividend obligation." So that had your resolution merely provided for the distribution of the stock as a dividend there would clearly have been no gain to the corporation.

A distinct similarity in terminology is noted in the resolution of your company and the Bacon-McMillan Veneer Company.

The resolution of the latter company was that a "fifty [fol. 9] per cent dividend be declared, and made payable in Liberty Loan Bonds, at their market value." Your resolution provided that a "dividend in the amount of $1,071,426.25 be and it is hereby declared payable in common stock of The Islands Edison Company at a valuation of $56.125 a share."

Both dividends declared were sums certain (the amount in the case of the Bacon-McMillan Veneer Company being rendered certain by computation), and both provided for the payment of the dividends in securities owned by the corporation at their market value at distribution.

It is therefore held that your corporation realized a taxable gain of $1,069,517.25 upon the distribution of The Islands Edison Company stock in payment of the dividend of $1,071,426.25, as follows:

Distribution of 19,090 shares of stock at market value of $56.125 a share in satisfaction of dividend obligation	$1,071,426.25
Cost of stock distributed, $0.10 a share	1,909.00
Profit realized	$1,069,517.25

HT-3.

General Utilities and Operating Company

Year Ended December 31, 1928

Schedule 3

Computation of Tax

Income Tax

Net income for taxable year	$1,100,199.08
Income tax 12%	$132,023.89
Total previously assessed	3,681.82
Additional tax to be assessed	$128,342.07

[fol. 10] Before United States Board of Tax Appeals

[Title omitted]

Answer—Filed March 10, 1931

The Commissioner of Internal Revenue by his attorney, General Counsel, Bureau of Internal Revenue, for answer to the petition filed by the above-named petitioner, admits and denies as follows:

1. Denies all the material allegations contained in paragraph 1 of the petition, except the allegation that the petitioner is a corporation and admits said allegation.

2. Admits all the material allegations contained in paragraph 2 of the petition.

3. Admits all the material allegations contained in paragraph 3 of the petition, except the allegation as to the amount of tax in controversy and denies that the amount of tax in controversy is the amount shown in paragraph 3 of the petition.

4 (a). Denies that the respondent committed error in the determination of the deficiency as alleged in paragraph 4 of the petition.

4 (b). Denies that any error was made in the determination of the deficiency referred to in deficiency letter dated December 16, 1930.

5. Denies all the material allegations contained in paragraph 5 of the petition.

[fol. 11] 6. Denies generally and specifically each and every allegation in the petitioner's petition contained not hereinbefore admitted, qualified or denied.

Wherefore it is prayed that the petitioner's appeal be denied.

(Signed) C. M. Charest, General Counsel, Bureau of Internal Revenue. Of Counsel: J. Arthur Adams, Special Attorney, Bureau of Internal Revenue.

BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

STIPULATION OF FACTS—Filed at Hearing Oct. 5, 1932

It is hereby stipulated and agreed by and between the parties hereto, by their respective counsel, that the following facts shall be taken as true and may be considered by the Board in its findings of fact and conclusions of law subject to the objection on the part of either party to any part thereof on the ground of relevancy.

1. The petitioner is a corporation organized under the laws of the State of Delaware on or about May 1, 1914, with its principal offices at 1310 Standard Oil Building, Balti-

more, Maryland, and for the calendar year 1928 filed its income tax return with the Collector of Internal Revenue at Baltimore, Maryland. Petitioner is engaged in the busi-
[fol. 12] ness of owning securities of, managing, and operating public utility properties.

2. On January 1, 1927, the petitioner corporation acquired 20,000 shares of no par value of the common capital stock, Certificate # C-2, (photostat copy of which is attached hereto and marked Exhibit A,) of another corporation, the Islands Edison Company. Said 20,000 shares of stock constituted one-half of the total 40,000 shares of common capital stock of said Islands Edison Company outstanding; the remaining 20,000 shares, Certificate # C-1, (photostat copy of which is attached hereto and marked Exhibit B,) were owned by Gillet and Company, Keyser Building, Baltimore, Maryland, which company is not connected with petitioner nor with petitioner's stockholders. Petitioner acquired said 20,000 shares of common capital stock of the Islands Edison Company at a cost to it of $2,000 and set up such stock on its books at a total value of $2,000.

3. During the month of January, 1928, Walter Whetstone, president of the Southern Cities Utilities Company, became interested in acquiring control of the Compania Electricia de Santo Domingo, the stock of which was owned by the Islands Edison Company. Upon inquiring of Gillet & Company, of Baltimore, he ascertained that the entire common stock outstanding of the Islands Edison Company was owned equally, as aforesaid, by Gillet & Company, of Baltimore, Maryland, and General Utilities & Operating Company, each company holding certificates for 20,000 shares. That during a conference with J. C. M. Lucas, president of the General Utilities & Operating Company, Mr. Whetstone discussed the purchase of the Santo Domingo Company or the Islands Edison Company common stock and as a result thereof was given permission to make an investigation of the properties of the Santo Domingo Company. That sometime in February of 1928 Mr. Whetstone informed Mr. Charles Gillet and Mr. J. C. M. Lucas that his plans required the delivery of all the common stock of the Islands Edison Company; that he was informed by Charles Gillet that his firm was ready and willing to make

the sale of the 20,000 shares owned by Gillet & Co. of the Islands Edison Company common stock and that he (Gillet) and Mr. Lucas, president of petitioner, had agreed upon [fol. 13] the price at which the sale would be made. Mr. Whetstone was informed by Mr. Lucas that if a sale of the 20,000 shares of the common stock of the Islands Edison Company then owned by the General Utilities & Operating Company was consummated such a sale would be made only after the General Utilities & Operating Company had distributed the Islands Edison Company shares to its stockholders, because they had been advised by their attorneys that if sale were made by General Utilities & Operating Company it would be subject to a tax on any profit realized on the sale and that when the proceeds of the sale were distributed to the stockholders the stockholders would have to pay another tax thereon. The price to be paid for the properties and generally the terms and conditions of the sale were agreed upon by Messrs. Gillet, Lucas and Whetstone, but no contract was entered into by them, it being understood and agreed between them that the General Utilities and Operating Company would make distribution of the common stock of the Islands Edison Company to its stockholders and that counsel would prepare a written agreement embodying the terms and conditions of the said sale, said agreement to be submitted for approval to the stockholders of the Islands Edison Company (after the distribution of said stock by the General Utilities and Operating Company).

It is stipulated and agreed that J. C. M. Lucas, if called as a witness in this proceeding, would testify as is shown in the affidavit attached hereto as Exhibit F.

4. On March 22, 1928 the following transpired at a meeting of the Board of Directors of the petitioner corporation as reflected by the minutes of said meeting:

"A meeting of the Board of Directors of the General Utilities and Operating Company was held this 22nd day of March, 1928, at the principal office of the Company, Standard Oil Building, Baltimore, Maryland, at eleven o'clock in the forenoon.

"Directors present: Messrs. George E. Warfield, E. McC. [fol. 14] Fisher, Frank B. Adams, Samuel P. Morton, Jr., J. C. M. Lucas and H. P. Lucas, constituting a majority and a quorum of the Board.

"Mr. J. C. M. Lucas, the President of the Company, presided, and Mr. H. P. Lucas, the Secretary of the Company, acted as Secretary of the meeting.

"A waiver of notice of the meeting, signed by Mr. E. H. Bankard, the remaining Director of the Company, who was not present at the meeting, was presented by the Secretary, and ordered filed.

"The Chairman called to the attention of the meeting the fact that the Company was carrying on its books 20,000 shares of Common Stock of the Islands Edison Company at a gross valuation of $2,000; he made an extended statement to the Board dealing with the development of and the present condition of the properties of that Company, its record of gross and net earnings and a forecast of the earnings which should be made in the immediate future as a result of extensions of facilities initiated and to a large extent completed; he stated that the officers of the Company after careful analysis of the properties and affairs of the Islands Edison Company, were of the opinion that the Common Stock of that Company which is owned by this Company is worth at least $1,122,500.00 and should be appreciated on the books of this Company to that amount; he explained that such an appreciation would, of course, involve a credit to surplus account of the Company arising from appreciation of assets and a debit to its asset account in the amount of $1,120,500.00.

"The Chairman also suggested to the meeting that the Company consider declaring a dividend on the Common Stock of the Company in the amount of $1,071,426.25, payable out of the appreciation so set up, the dividend to be paid in Common Stock of the Islands Edison Company at a value of $56.12½ a share.

"Whereupon the following resolutions were unanimously passed, viz:

[fol. 15] (a) that this Company appreciate on its books, its holdings of Common Stock of The Islands Edison Company in the amount of 20,000 shares in the amount of $1,120,500.00 and that the amount of this appreciation be credited to surplus arising from appreciation of assets;

(b) that a dividend in the amount of $1,071,426.25 be and it is hereby declared on the Common Stock of this Company, payable in Common Stock of The Islands Edison Company

at a valuation of $56.12½ a share, out of the surplus of the Company arising from the appreciation in the value of the Common Stock of The Islands Edison Company held by this Company, viz., $1,120,500.00, the payment of the dividend to be made by the delivery to the stockholders of this Company, pro rata, of certificates for the Common Stock of The Islands Edison Company held by this Company at the rate of two shares of such stock for each share of Common Stock of this Corporation; the stockholders entitled to be those of record at the close of business this day.

"There being no further business before the meeting it then adjourned."

5. The petitioner thereupon, on March 22, 1928, simultaneously entered on its books of account. in compliance with the foregoing resolution, the following entries:

1928.		Dr.	*Dr.*
Mar. 22.	Investments	1,120,500.00	
	Surplus arising from appreciation of assets		1,120,500.00
	To record the appreciation in the market value of the Company's holding of 20,000 shares of Common Stock of The Islands Edison Company as authorized by Board of Directors by resolution passed in meeting held		
[fol. 16]	22nd day of March, 1928.		
	20,000 shares cost	2,000.00	
	20,000 shares appreciated value	1,122,500.00	
		1,120,500.00	
Mar. 22.	Surplus arising from appreciation of assets	1,071,426.25	
	Dividends payable		1,071,426.25

To record dividend declared on the Common Stock of the Company, payable in Common Stock of The Islands Edison Company at a valuation of $56.12½ a share, out of the Surplus arising from the appreciation in the value of the Common Stock of the Islands Edison Company held by this Company, namely, $1,120,500, the payment of the dividend to be made by the delivery to the stockholders of this Company, pro rata, of certificates for the Common Stock of The Islands Edison Company held by this Company at the rate of two shares of such stock for each share of Common Stock of this Corporation; the stockholders entitled to be those of record at the close of business this day as authorized by the Board of Directors by resolution passed in meeting held 22nd day of March, 1928. Number of shares of this Company issued and outstanding at this date—9545.

[fol. 17]

Mar. 22.	Dividends payable	1,071,426.25	
	Investments		1,071,426.25

To record payment of dividend declared March 22, 1928, on the Common Stock of this Company, such payment being made by delivery of 19,090 shares of the Common Stock of The Islands Edison Company at a valuation of $56.12½ per share.

6. Thereupon, on March 22, 1928, in accordance with the resolution of the Board of Directors hereinabove set forth, the petitioner distributed to its own stockholders, 19,090 shares of the said common capital stock of the Islands Edison Company, such shares representing two shares of the Islands Edison Company stock theretofore owned by petitioner for each one share of the 9,545 shares of petitioners' own capital stock then outstanding. On such date, March 22, 1928, the said shares of stock were transferred on the stock records of the Islands Edison Company to the individuals receiving the distribution; the certificate, #C-2, theretofore issued to the petitioner was cancelled, and certificates #C-3 to 35 (photostats of which are attached hereto marked Exhibit C) were issued to the following individuals, [fol. 18] being the stockholders of petitioner corporation at that date who received such distribution:

Name	Number of shares
J. C. M. Lucas Company	6,740
Bessie M. Slagle	220
W. V. Horner	150
Cornelia R. Bryan	70
J. Harmanus Fisher & Sons	1,250
Edward McC. Fisher	140
Samuel P. Morton, Jr.	560
Georgia S. Foster	540
John Walter Smith Foster	550
Arthur D. Foster, Jr.	540
Eugene L. Norton	150
Rose J. Coleman	3,480
E. H. Bankard	500

Name	Number of shares
S. Baldwin, Jr.	130
Leo P. Harlow	230
May Gover	150
Henry T. Gover	150
J. E. Hutchinson, Jr.	150
Alvin O. Portner	500
Geo. E. Warfield	280
Benoit Baer, Jr.	100
Arthur K. Warfield	20
Edgar Warfield, Jr.	130
Virgil T. Bain	100
C. D. Hubbard	50
Anna Edgar Lucas	150
William F. Hall	100
Joseph A. Slattery	250
Victor C. Armstrong	100
H. H. Coleman	50
A. S. Swanson	20
M. A. Maxwell	550
J. B. Whitworth	990

After transfer of the 19,090 shares as aforesaid, there remained in the hands of petitioner 910 shares of stock of The Islands Edison Company, which 910 shares were retained by it and a new certificate, C-36 (photostat copy of which is attached and marked Exhibit "D") was issued to it on March 22, 1928.

[fol. 19] 7. On March 26, 1928, the stockholders of The Islands Edison Company (one of which was the petitioner, General Utilities and Operating Company, the owner of 910 shares of Islands Edison Company common stock) and the Southern Cities Utilities Company entered into a contract of sale of The Islands Edison Company common stock, a photostat copy of which contract is attached hereto and marked Exhibit "E"; that at no time did General Utilities and Operating Company agree with the aforesaid Walter Whetstone or the Southern Cities Utilities Company, verbally or in writing, to make sale to him or to the Southern Cities Utilities Company of any of said stock except the aforesaid 910 shares of the Islands Edison Company.

8. The fair market value of The Islands Edison Company common stock as of March 22, 1928, was $56.12½ per share,

said amount being computed in the aforesaid contract dated March 26, 1928, attached hereto as Exhibit E, as follows:

Total sales price as shown in contract	$3,375,000.00
Less: Liability for bonds and preferred stock outstanding	1,130,000.00
Net consideration for stock	$2,245,000.00

$2,245,000 divided by 40,000 shares equals $56.12½ per share.

9. The earned surplus from operations as of December 31, 1927, was $1,360,515.96, which amount was not impaired by operating losses prior to March 22, 1928. Such surplus and all the capital of the company at December 31, 1927, were invested at cost in assets of the company, of which assets only $41,152.00 was cash. On March 22, 1928, the total cash of petitioner was not more than $49,004.23.

10. The 910 shares of The Islands Edison Company common stock, Certificate #C-36, which were retained by the petitioner after the said distribution of 19,090 shares to its stockholders on March 22, 1928, as referred to in paragraph 6 of this stipulation, were sold to the Southern Cities Utili- [fol. 20] ties Company on May 14, 1928, in accordance with the provisions of paragraph 7 of this stipulation, and on which a profit of $46,346.30 was reported on the 1928 return as filed by the petitioner, computed in said return as follows:

Sales price of 910 shares at $51.25 per share	$46,437.30
Cost of 910 shares at 10¢ per share	91.00
Profit reported in return	$46,346.30

The difference between the amount of $56.12½ per share, set forth in paragraph 8 above as the price stated in the contract of March 26, 1928, and the amount of $51.25 as shown in this paragraph as the amount received on May 14, 1928, when sale was made, is represented by brokerage charges, commissions and other expenses incident to the consummation of the sale which were charged against the stockholders in accordance with paragraph Eighth of the contract dated March 26, 1928, attached hereto as Exhibit E.

11. The petitioner received no cash or other property for the distribution of said 19,090 shares of the Islands Edison Company common stock.

12. Petitioner corporation, in making its income tax return for the calendar year 1928, reported no income from the disposition of the 19,090 shares of the Islands Edison common stock. The Commissioner of Internal Revenue, upon auditing said return, has held that petitioner corporation derived a profit of $1,069,517.25 from the disposition thereof, the Commissioner's ruling thereon being in part, as follows:

"It is therefore held that your corporation realized a taxable gain of $1,069,517.25 upon the distribution of The Islands Edison Company stock in payment of the dividend of $1,071,426.25, as follows:

[fol. 21] Distribution of 19,090 shares of stock at market value of $56.125 a share in satisfaction of dividend obligation	$1,071,426.25
Cost of stock distributed, $0.10 a share	1,909.00
Profit realized	$1,069,517.25"

(Sgd.) R. Kemp Slaughter, (Sgd.) Hugh C. Bickford, Attorneys for Petitioner. (Sgd.) C. M. Charest, General Counsel, Bureau of Internal Revenue, Attorney for Respondent.

PEW, 9/27/32.
RGW, 9/27/32.

EXHIBIT "F" TO STIPULATION OF FACTS

CITY OF BALTIMORE,
State of Maryland, ss:

J. C. M. Lucas being duly sworn according to law deposes and says as follows:

1. That I am President of General Utilities & Operating Company, a corporation of the State of Delaware, with its executive offices in the City of Baltimore, Maryland, and that I have been President of said Company since its organization on the 1st day of May, 1914.

2. That I was present at the meeting of the Board of Directors of said Company, held March 22, 1928, at which common stock of The Islands Edison Company was ordered to be distributed to the stockholders of General Utilities & Operating Company; that the contract for the sale of said stock and all matters in connection with said transaction were handled by counsel and I had no part in the preparation thereof; that I have no recollection of any contract having been prepared in which I was named as one party to the agreement as "Seller" and Southern Cities Utilities Company, the other party, as "Purchaser"; that the entire [fol. 22] proceedings of the Board of Directors of General Utilities & Operating Company appear in the corporate record book of said Company and the agreement for sale of said stock was entered into by all of the stockholders of The Islands Edison Company and Southern Cities Utilities Company after General Utilities & Operating Company had made distribution of said stock to its stockholders; that my recollection of the transaction leading up to and the execution of the contract between the stockholders of The Islands Edison Company and Southern Cities Utilities Company accords with the facts as set forth in an affidavit heretofore made by Walter Whetstone, President of Southern Cities Utilities Company, which has heretofore been filed with the Commissioner of Internal Revenue or one of the Departments before which the tax assessment against General Utilities & Operating Company has been considered.

3. That the irrevocable powers of attorney attached to the shares of stock in the names of the individual owners were not executed by the individuals prior to March 22, 1928, when said stock was distributed to them by General Utilities & Operating Company, but same were executed after the distribution of said stock and prior to the execution of the contract of March 26, 1928; although some of said powers of attorney may have been executed after March 26, 1928, but none prior to March 22, 1928.

4. That I did not have power of attorney from the Board of Directors of General Utilities & Operating Company at any time to dispose of the common stock of The Islands Edison Company; that the entire proceedings of the Board of Directors of said Company are set forth in the corporate record book of said Company and said proceedings do not

show any authority to me at any time to dispose of such stock.

5. That I did not have power of attorney from Gillet & Company or a bill of sale from them, either to me or General Utilities & Operating Company, for the sale of common stock of The Islands Edison Company owned by Gillet & Company; that said Gillet & Company joined with the other stockholders of The Islands Edison Company in the [fol. 23] execution of the contract of March 26, 1928, and delivered their stock with irrevocable power of attorney attached to The Pennsylvania Company for Insurance on Lives and Granting Annuities, with authority to said Company to make delivery of such certificates at settlement.

J. C. M. Lucas.

Sworn to and subscribed before me this 24th day of September, 1932.

Agnes A. Sandkuhler.

Before United States Board of Tax Appeals

Docket No. 52770

Promulgated April 24, 1933

General Utilities & Operating Company, Petitioner,

v.

Commissioner of Internal Revenue, Respondent

Findings of Fact and Opinion

A dividend declared by petitioner corporation, payable in stock of another corporation and so paid, did not give rise to taxable gain.

R. Kemp Slaughter, Esq., Hugh C. Bickford, Esq., and Joseph A. Slattery, Esq., for the petitioner.

William E. Davis, Esq., and Paul E. Waring, Esq., for the respondent.

The respondent has determined a deficiency in income tax in the amount of $128,342.07 for the calendar year 1928.

The only question presented in this proceeding for redetermination is whether petitioner realized taxable gain in declaring a dividend and paying it in the stock of another [fol. 24] company at an agreed value per share, which value was in excess of the cost of the stock to petitioner.

Findings of Fact

1. The petitioner is a Delaware corporation, with its principle offices at Baltimore, Maryland. It is engaged in the business of owning securities of, managing, and operating public utility properties.

2. On January 1, 1927, the petitioner acquired 20,000 shares of no par value of the common capital stock of another corporation, the Islands Edison Company. Said 20,000 shares of stock constituted one-half of the total common capital stock of said Islands Edison Company outstanding; the remaining 20,000 shares were owned by Gillet & Company, which company is not connected with petitioner nor with petitioner's stockholders. Petitioner acquired said 20,000 shares of common capital stock of the Islands Edison Company at a cost to it of $2,000 and set up such stock on its books at a total value of $2,000.

3. During the month of January, 1928, Walter Whetstone, president of the Southern Cities Utilities Company, became interested in acquiring control of a Santo Domingo company, the stock of which was owned by the Islands Edison Company. Upon inquiring of Gillet & Company he ascertained that the entire common stock outstanding of the Islands Edison Company was owned equally, as aforesaid, by Gillet & Company and petitioner. During a conference with J. C. M. Lucas, president of petitioner, Whetstone discussed the purchase of the Santo Domingo Company or the Islands Edison Company common stock and as a result thereof was given permission to make an investigation of the properties of the Santo Domingo Company. Sometime in February of 1928 Whetstone informed Gillet and Lucas that his plans required the delivery of all the common stock of the Islands Edison Company, that he was informed by Gillet that his firm was ready and willing to make the sale of the 20,000 shares owned by Gillet & Company of the Islands Edison Company common stock, and that he (Gillet) and Lucas, president of petitioner, had agreed upon the price

[fol. 25] at which the sale would be made. Whetstone was informed by Lucas that if a sale of the 20,000 shares of the common stock of the Islands Edison Company then owned by the petitioner were consummated such a sale would be made only after petitioner had distributed the Islands Edison Company shares to its stockholders, because they had been advised by their attorneys that if sale were made by petitioner it would be subject to a tax on any profit realized on the sale and that when the proceeds of the sale were distributed to the stockholders the stockholders would have to pay another tax thereon. The price to be paid for the properties and generally the terms and conditions of the sale were agreed upon by Gillet, Lucas, and Whetstone, but no contract was entered into by them, it being understood and agreed between them that petitioner would make distribution of the stock of the Islands Edison Company to its stockholders and that counsel would prepare a written agreement embodying the terms and conditions of the said sale, said agreement to be submitted for approval to the stockholders of the Islands Edison Company after the distribution of said stock by the petitioner. Lucas never held power of attorney to sell said stock for the petitioner or its stockholders.

4. At a meeting of petitioner's directors on March 22, 1928, the matter of petitioner's stockholdings in the Islands Edison Company was discussed and it was reported as the opinion of petitioner's officers that the stock was worth at least $1,122,500 and that it should be appreciated on petitioner's books to that figure. Further matters discussed and action taken at that meeting are recorded in the minutes as follows:

The Chairman also suggested to the meeting that the Company considered declaring a dividend on the Common Stock of the Company in the amount of $1,071,426.25, payable out of the appreciation so set up, the dividends to be paid in Common Stock of the Islands Edison Company at a value of $56.12½ a share.

Whereupon the following resolutions were unanimously passed, viz:

(a) that this Company appreciate on its books, its holdings of Common Stock of The Islands Edison Company in [fol. 26] the amount of 20,000 shares in the amount of

$1,120,500.00 and that the amount of this appreciation be credited to surplus arising from appreciation of assets;

(b) that a dividend in the amount of $1,071,426.25 be and it is hereby declared on the Common Stock of this Company payable in Common Stock of The Islands Edison Company at a valuation of $56.12½ a share, out of the surplus of the Company arising from the appreciation in the value of the Common Stock of The Islands Edison Company held by this Company, viz, $1,120,500.00, the payment of the dividend to be made by the delivery to the stockholders of this Company pro rata, of certificates for the Common Stock of The Islands Edison Company held by this Company at the rate of two shares of such stock for each share of Company Stock of this Corporation; the stockholders entitled to be those of record at the close of business this day.

There being no further business before the meeting, it then adjourned.

5. The petitioner thereupon, on March 22, 1928, simultaneously entered on its books of account, in compliance with the foregoing resolution, the following entries, with full explanation following each entry, only part of which is here set forth:

1928		Dr.	Cr.
March 22.	Investments	$1,120,500.00	
	Surplus arising from appreciation of assets		$1,120,500.00
March 22.	Surplus arising from appreciation of assets	1,071,426.25	
	Dividends payable		1,071,426.25
	To record dividend declared on the Common Stock of the Company, payable in Common Stock of The		
[fol. 27]	Islands Edison Company at a valuation of $56.12½ a share, * * *		
March 22.	Dividends payable	1,071,426.25	
	Investments		1,071,426.25
	To record payment of dividends declared March 22, 1928, on the Common Stock of this Company, such payment being made by delivery of 19,090 shares of the Common Stock of The Islands Edison Company at a valuation of $56.12½ per share.		

6. Thereupon, on March 22, 1928, in accordance with the resolution of the directors the petitioner distributed to its own stockholders, 19,090 shares of the stock of the Islands

Edison Company, such shares representing two shares of the Islands Edison Company stock theretofore owned by petitioner for each one share of the 9,545 shares of petitioner's own capital stock then outstanding. On the same date, March 22, 1928, the shares of stock were transferred on the stock records of the Islands Edison Company to the individuals receiving the distribution. After transfer of the 19,090 shares, there remained in the hands of petitioner 910 shares of stock of the Islands Edison Company, which 910 shares were retained by it and a new certificate for such shares was issued to it on March 22, 1928.

7. On March 26, 1928, the stockholders of the Islands Edison Company (one of which was the petitioner, owning 910 shares) and the Southern Cities Utilities Company, entered into a written contract of sale of the Islands Edison Company stock. At no time did petitioner agree with Whetstone or the Southern Cities Utilities Company, verbally or in writing, to make sale to him or to the Southern Cities Utilities Company of any of said stock except the [fol. 28] aforesaid 910 shares of the Islands Edison Company.

8. The fair market value of the Islands Edison Company stock as of March 22, 1928, was $56.12½ per share, said amount being computed in the contract dated March 26, 1928, as follows:

Total sales price	$3,375,000
Less: Liability for bonds and preferred stock outstanding	1,130,000
Net consideration for stock	$2,245,000

The net consideration, $2,245,000, divided by the number of shares, 40,000, gives a quotient of $56.12½ per share.

9. Petitioner's earned surplus from operations as of December 31, 1927, was $1,360,515.96, which amount was not impaired by operating losses prior to March 22, 1928. Such surplus and all the capital of the petitioner at December 31, 1927, were invested at cost in assets of the company, of which assets only $41,152 was cash. On March 22, 1928, the total cash of petitioner was not more than $49,004.23.

10. The 910 shares of the Islands Edison Company common stock which were retained by the petitioner after the distribution of 19,090 shares to its stockholders on March 22, 1928, were sold to the Southern Cities Utilities Company on May 14, 1928, and a profit of $46,346.30 was reported on the 1928 return filed by the petitioner, computed as follows:

Sale price of 910 shares at $51.25 per share	$46,437.30
Cost of 910 shares at 10¢ per share	91.00
Profit reported in return	$46,346.30

The difference between the amount of $56.12½ per share, set forth above as the price stated in the contract of March 26, 1928, and the amount of $51.25 as shown in this paragraph as the amount received on May 14, 1928, when sale was made, is represented by brokerage charges, commissions [fol. 29] and other expenses incident to the consummation of the sale which were charged against the stockholders in accordance with the provision of the contract.

11. The petitioner received no cash or other property for the distribution of said 19,090 shares of the Islands Edison Company common stock.

12. Petitioner, in making its income tax return for the calendar year 1928, reported no income from the disposition of the 19,090 shares of the Islands Edison common stock. The respondent upon auditiing the return, has held that petitioner corporation derived a profit of $1,069,517.25 from the disposition thereof, the explanation in the notice of deficiency being in part as follows:

It is therefore held that your corporation realized a taxable gain of $1,069,517.25 upon the distribution of The Islands Edison Company stock in payment of the dividend of $1,071,426.25, as follows:

Distribution of 19,090 shares of stock at market value of $56.125 a share in satisfaction of dividend obligation	$1,071,426.25
Cost of stock distributed, $0.10 a share	1,909.00
Profit realized	$1,069,517.25

OPINION

ARUNDELL:

The respondent has determined that income was realized from the transactions detailed in the findings of fact and has asserted a tax thereon. His theory is that upon the declaration of the dividend on March 22, 1928, petitioner became indebted to its stockholders in the amount of $1,071,426.25, and that the discharge of that liability by the delivery of property costing less than the amount of the debt constituted income, citing Kirby Lumber Co. v. United States, 284 U. S. 1.

There are a number of decided cases somewhat similar to this, in some of which it has been held that the distributions resulted in gain or loss to the distributing cor- [fol. 30] poration. See Callanan Road Improvement Co., 12 B. T. A. 1109; Bacon-McMillan Veneer Co., 20 B. T. A. 556. In those cases the dividend resolutions were construed as declaring dividends in definite amounts "*before* the property was distributed in kind." Bacon-McMillan Veneer Co., supra, p. 559. In this last cited case it was further said:

If, on the other hand, instead of providing for a definite percentage in the way of a dividend, if the resolution had merely provided that the Liberty bonds should be distributed by way of dividends, a different situation would have been presented which is clearly distinguishable from the case we have before us.

A situation like that mentioned in the quotation just given was present in First Utah Savings Bank, 17 B. T. A. 804; affd., 53 Fed. (2d) 919. There the banking corporation owned the stock of another company, which stock was held by trustees, and the bank's directors by resolution directed the trustees "to deliver as a dividend" a designated number of shares of the stock. "No cash dividend had been declared by the bank as a part of this transaction." 53 Fed. (2d) 920. The stock at the time of distribution was worth less than cost. We held:

The petitioner, by resolution of its board of directors, of October 17, 1922, only incurred an obligation to distribute the 9,000 shares of Amalgamated Sugar Co. stock to its stockholders, which obligation it fully discharged without

loss to it, by making the distribution of the stock as directed.

The facts in this case are somewhat analogous to those in Hollenberg Music Co., 6 B. T. A. 421, 425, wherein we said—referring to a dividend declared by the petitioner:

• • • If, as the resolution of February 6, 1917, indicates, the petitioner merely distributed the property interest along with other dividends, we are unable to see that loss, contingent or otherwise, resulted from the distribution. • • •

The Court of Appeals of the District of Columbia in affirming our decision said:

[fol. 31] It is true that the rule hereby adopted leads to an anomalous result, inasmuch as appellant at the time of transferring the stock had suffered an actual loss of value measured by the difference between the cost of the transferred stock and its then market price, for which no deduction is allowed. But, on the other hand, according to the same rule if the transferred stock had enhanced in value between its purchase and transfer no taxable gain would have been charged against the corporation because of that fact.

From the above cases the rule is deducible that, where the dividend resolution imposes only the obligation to distribute in kind and it is discharged in that way, no gain or loss results to the corporation. Counsel for respondent in his brief concedes this to be the correct view.

Our question then is to determine whether the resolution of March 22, 1928, was one declaring a dividend of an amount of money, or whether it declared a dividend payable in stock of the Islands Edison Company. The second paragraph of the resolution opens with the statement: "That a dividend in the amount of $1,071,426.25 be and it is hereby declared on the common stock of this Company • • •." The respondent would have us stop reading here. This, however, is only part of the resolution, and the part that immediately follows is of equal importance. The next clause limits as clearly as words can the medium of discharge of the dividend liability. Without separation by as much as a punctuation mark from the part of the resolution just quoted, the words are: "payable in common stock of the Islands Edison Company • • •." Where

the method of payment is prescribed a stockholder is not entitled to payment in some other form. In State v. B. & O. R. R., 6 Gill (Md.) 363, the railroad company had declared a dividend, payable in cash to holders of less than 50 shares, and payable part in cash and part in its own bonds to holders of 50 shares or more. The State of Maryland, being the owner of more than 50 shares, sued for a cash payment of the entire amount. The court denied recovery, saying in part:

It is immaterial in our view of the subject, whether the declaration of a dividend constitutes a contract, or is to be considered in the light of a performance of a duty. In [fol. 32] either case, *it is to be taken as it emanates from the board. A part of it cannot be taken and the rest discarded.* It cannot be said you have declared three per cent and we will have the money, although in the very declaration, they say they can only pay you in liabilities of the company. P. 386.

The intent of the directors of petitioner was to declare a dividend payable in Islands Edison stock; their intent was expressed in that way in the resolution formally adopted; and the dividend was paid in the way intended and declared. We so construe the transaction, and on authority of First Utah Savings Bank, supra, we hold that the declaration and payment of the dividend resulted in no taxable income.

Decision will be entered for the petitioner.

BEFORE UNITED STATES BOARD OF TAX APPEALS,

Washington

Docket No. 52770

GENERAL UTILITIES & OPERATING CO., Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

DECISION

Pursuant to the Board's findings of fact and opinion, promulgated April 24, 1933, it is

Ordered and decided that there is no deficiency in income tax for the year 1928.

Enter.

(Signed) C. Rogers Arundell, Member, United States Board of Tax Appeals.

Entered Apr. 27, 1933.

[fol. 33] BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

MOTION FOR REHEARING, ETC.—Filed May 17, 1933

Comes now the Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, and moves that the Chairman of the Board direct that the decision of the Division of the Board in this proceeding be reconsidered by the Board and that the Board recall its decision in this proceeding promulgated April 24, 1933, and grant a rehearing, if such rehearing is deemed necessary.

For cause it is stated that the principle involved is one of great importance in the administration of the income tax laws and is contrary to a long established practice of the Bureau of Internal Revenue. Further, it appears that the Board's decision is contrary to, and cannot be reconciled with, its decisions in Bacon-McMillan Veneer Company, 20 B. T. A. 556, and Callanan Road Improvement Company, 12 B. T. A. 1109. The question involved is whether or not the petitioner realized taxable gain in the declaration of a dividend in a specific amount and discharging such dividend in Islands Edison Company stock at an agreed value per share, which value was in excess of the cost of such stock to the petitioner. It was the contention of the respondent that the petitioner when it liquidated a definite dividend obligation to its stockholders by turning over to such stockholders an asset which cost the petitioner less than the face of the dividend a profit resulted therefrom to the petitioner. It was the position of the petitioner, which position was sustained by the Board, that the resolution constituted the [fol. 34] declaration of a dividend in kind and no tax liability in respect thereto arose to the petitioner.

The dividend resolution in the Bacon-McMillan Veneer Company case, 20 B. T. A. 556-557, reads:

"Dividends. It was moved by Mr. Frazer and seconded by Mr. Denner that a 50% dividend be declared and made payable in Liberty Loan Bonds in denominations of $1,000 each at their market value this date and all odd hundred of dollars and cents in cash".

The resolution in the case now under consideration is quoted on page 3 of the Board's decision and reads in part as follows:

"* * * That a dividend in the amount of $1,071,426.25 be and it is hereby declared * * * payable in common stock of the Islands Edison Company at a valuation of $56.12½ a share * * * payment of the dividend to be made by delivery to the stockholders of this company pro rata of certificates for the common stock of the Islands Edison Company held by this company at the rate of two shares of such stock for each 'share of the Company stock of this corporation'."

Under the resolution in the Bacon-McMillan Veneer Company appeal the Board held that a dividend of a definite amount paid in Liberty bonds of a value in excess of cost gives rise to taxable gain.

In the instant appeal the Board held that a dividend declared by the petitioner corporation payable in stock of another corporation and so paid did not give rise to taxable gain.

The decision in the instant case is clearly contrary to the decision of the Board in the case of Bacon-McMillan Veneer Company.

In view of the apparent conflict between those decisions of the Division of the Board, which have become the decisions of the Board, respondent finds that considerable administrative difficulty has arisen particularly from the standpoint of the administration of the tax law, in this re- [fol. 35] spect, by the revenue agents in the field. Because of the patent conflict and because of this administrative difficulty, it is prayed that this motion be granted to the end that the said conflict might be eliminated.

(Signed) C. M. Charest, General Counsel, Bureau of Internal Revenue. Of counsel: William E. Davis and Paul E. Waring, Special Attorneys, Bureau of Internal Revenue.

BEFORE UNITED STATES BOARD OF TAX APPEALS, WASHINGTON

[Title omitted]

ORDER RECALLING REPORT AND DETERMINATION, ETC.

Upon consideration of the motion filed by counsel for the respondent to refer the report and determination in this proceeding, promulgated under date of April 24, 1933, to the Board for review, it is

Ordered that said motion be and the same is hereby denied. And it is further

Ordered that said report and determination be and the same is hereby recalled and the proceeding referred to Division No. 4 for consideration and report. And it is further

Ordered that the decision based on said report entered [fol. 36] under date of April 27, 1933 be and the same is hereby vacated, set aside and made for naught.

By the Board.

(Signed) Logan Morris, Chairman.

Dated: Washington, D. C., May 26, 1933.

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 52770

Promulgated January 30, 1934

GENERAL UTILITIES & OPERATING COMPANY, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Findings of Fact and Opinion

A dividend declared by petitioner corporation, payable in stock of another corporation and so paid, did not give rise to taxable gain.

R. Kemp Slaughter, Esq., Hugh C. Bickford, Esq., and Joseph A. Slattery, Esq., for the petitioner.

William E. Davis, Esq., and Paul E. Waring, Esq., for the respondent.

The respondent has determined a deficiency in income tax in the amount of $128,342.07 for the calendar year 1928. The only question presented in this proceeding for redetermination is whether petitioner realized taxable gain in declaring a dividend and paying it in the stock of another company at an agreed value per share, which value was in excess of the cost of the stock to petitioner.

[fol. 37] FINDINGS OF FACT

1. The petitioner is a Delaware corporation, with its principal offices at Baltimore, Maryland. It is engaged in the business of owning securities of, managing, and operating public utility properties.

2. On January 1, 1927, the petitioner acquired 20,000 shares of no par value of the common capital stock of another corporation, the Islands Edison Company. Said 20,000 shares of stock constituted one-half of the total common capital stock of the Islands Edison Company outstanding; the remaining 20,000 shares were owned by Gillet & Company, which company is not connected with petitioner nor with petitioner's stockholders. Petitioner acquired the 20,000 shares of common capital stock of the Islands Edison Company at a cost to it of $2,000 and set up such stock on its books at a total value of $2,000.

3. During the month of January, 1928, Walter Whetstone, president of the Southern Cities Utilities Company, became interested in acquiring control of a Santo Domingo company, the stock of which was owned by the Islands Edison Company. Upon inquiring of Gillet & Company he ascertained that the entire common stock outstanding of the Islands Edison Company was owned equally, as aforesaid, by Gillet & Company and petitioner. During a conference with J. C. M. Lucas, president of petitioner, Whetstone discussed the purchase of the Santo Domingo Company or the Islands Edison Company common stock and as a result thereof was given permission to make an investigation of the properties of the Santo Domingo Company. Sometime in February of 1928 Whetstone informed Gillet and Lucas that his plans required the delivery of all the common stock of the Islands Edison Company, that he was informed by Gillet that his firm was ready and willing to make the sale of the 20,000 shares owned by Gillet & Company of

the Islands Edison Company common stock and that he (Gillet) and Lucas, president of petitioner, had agreed upon the price at which the sale would be made. Whetstone was informed by Lucas that if a sale of the 20,000 shares of the common stock of the Islands Edison Company then owned by the petitioner were consummated such [fol. 38] a sale would be made only after petitioner had distributed the Islands Edison Company shares to its stockholders, because they had been advised by their attorneys that if sale were made by petitioner it would be subject to a tax on any profit realized on the sale and that when the proceeds of the sale were distributed to the stockholders, the stockholders would have to pay another tax thereon. The price to be paid for the properties and the terms and conditions of the sale generally were agreed upon by Gillet, Lucas, and Whetstone, but no contract was entered into by them, it being understood and agreed between them that petitioner would make distribution of the stock of the Islands Edison Company to its stockholders and that counsel would prepare a written agreement embodying the terms and conditions of the sale, the agreement to be submitted for approval to the stockholders of the Islands Edison Company after the distribution of said stock by the petitioner. Lucas never held power of attorney to sell the stock for the petitioner or its stockholders.

4. At a meeting of petitioner's directors on March 22, 1928, the matter of petitioner's stockholdings in the Islands Edison Company was discussed and it was reported as the opinion of petitioner's officers that the stock was worth at least $1,122,500 and that it should be appreciated on petitioner's books to that figure. Further matters discussed and action taken at that meeting are recorded in the minutes as follows:

The Chairman also suggested to the meeting that the Company considered declaring a dividend on the Common Stock of the Company in the amount of $1,071,426.25, payable out of the appreciation so set up, the dividends to be paid in Common Stock of the Islands Edison Company at a value of $56.12½ a share.

Whereupon the following resolutions were unanimously passed, viz:

(a) that this Company appreciate on its books, its holdings of Common Stock of The Islands Edison Company in the amount of 20,000 shares in the amount of $1,120,500.00 and that the amount of this appreciation be credited to surplus arising from appreciation of assets;

[fol. 39] (b) that a dividend in the amount of $1,071,426.25 be and it is hereby declared on the Common Stock of this Company payable in Common Stock of The Islands Edison Company at a valuation of $56.12½ a share, out of the surplus of the Company arising from the appreciation in the value of the Common Stock of The Islands Edison Company held by this Company, viz, $1,120,500.00, the payment of the dividend to be made by the delivery to the stockholders of this Company pro rata, of certificates for the Common Stock of The Islands Edison Company held by this Company at the rate of two shares of such stock for each share of Company Stock of this Corporation; the stockholders entitled to be those of record at the close of business this day.

There being no further business before the meeting, it then adjourned.

5. The petitioner thereupon, on March 22, 1928, simultaneously entered on its books of account, in compliance with the foregoing resolution, the following entries, with full explanation following each entry, only part of which is here set forth:

1928		Dr.	Cr.
March 22.	Investments	$1,120,500.00	
	Surplus arising from appreciation of assets		$1,120,500.00
March 22.	Surplus arising from appreciation of assets	1,071,426.25	
	Dividends payable		1,071,426.25
	To record dividend declared on the Common Stock of the Company, payable in Common Stock of The Islands Edison Company at a valuation of $56.12½ a share, * * *		
March 22.	Dividends payable	1,071,426.25	
	Investments		1,071,426.25
[fol. 40]	To record payment of dividends declared March 22, 1928, on the Common Stock of this Company, such payment being made by delivery of 19,090 shares of the Common Stock of The Islands Edison Company at a valuation of $56.12½ per share.		

6. Thereupon, on March 22, 1928, in accordance with the resolution of the Directors the petitioner distributed to its own stockholders, 19,090 shares of the stock of the Islands Edison Company, such shares representing two shares of the Islands Edison Company stock theretofore owned by petitioner for each one share of the 9,545 shares of petitioner's own capital stock then outstanding. On the same date, March 22, 1928, the shares of stock were transferred on the stock records of the Islands Edison Company to the individuals receiving the distribution. After transfer of the 19,090 shares, there remained in the hands of petitioner 910 shares of stock of the Islands Edison Company, which 910 shares were retained by it and a new certificate for such shares was issued to it on March 22, 1928.

7. On March 26, 1928, the stockholders of the Islands Edison Company (one of which was the petitioner, owning 910 shares) and the Southern Cities Utilities Company, entered into a written contract of sale of the Islands Edison Company stock. At no time did petitioner agree with Whetstone or the Southern Cities Utilities Company, verbally or in writing, to make sale to him or to the Southern Cities Utilities Company of any of said stock except the 910 shares of the Islands Edison Company.

8. The fair market value of the Islands Edison Company stock as of March 22, 1928, was $56.12½ per share, said amount being computed in the contract dated March 26, 1928, as follows:

[fol. 41] Total sales price	$3,375,000
Less: Liability for bonds and preferred stock outstanding	1,130,000
Net consideration for stock	$2,245,000

The net consideration, $2,245,000, divided by the number of shares, 40,000, gives a quotient of $56.12½ per share.

9. Petitioner's earned surplus from operations as of December 31, 1927, was $1,360,515.96, which amount was not impaired by operating losses prior to March 22, 1928. Such surplus and all the capital of the petitioner at December 31, 1927, were invested at cost in assets of the company, of which assets only $41,152 was cash. On March 22,

1928, the total cash of petitioner was not more than $49,004.23.

10. The 910 shares of the Islands Edison Company common stock which were retained by the petitioner after the distribution of 19,090 shares to its stockholders on March 22, 1928, were sold to the Southern Cities Utilities Company on May 14, 1928, and a profit of $46,346.30 was reported on the 1928 return filed by the petitioner, computed as follows:

Sale price of 910 shares at $51.25 per share	$46,437.30
Cost of 910 shares at 10¢ per share	91.00
Profit reported in return	$46,346.30

The difference between the amount of $56.12½ per share, set forth above as the price stated in the contract of March 26, 1928, and the amount of $51.25 as shown in this paragraph as the amount received on May 14, 1928, when sale was made, is represented by brokerage charges, commissions and other expenses incident to the consummation of the sale which were charged against the stockholders in accordance with the provisions of the contract.

11. The petitioner received no cash or other property for the distribution of the 19,090 shares of the Islands Edison Company common stoock.

[fol. 42] 12. Petitioner, in making its income tax return for the calendar year 1928, reported no income from the disposition of the 19,090 shares of the Islands Edison common stock. The respondent upon auditing the return, has held that petitioner corporation derived a profit of $1,069,517.25 from the disposition thereof, the explanation in the notice of deficiency being in part as follows:

It is therefore held that your corporation realized a taxable gain of $1,069,517.25 upon the distribution of The Islands Edison Company stock in payment of the dividend of $1,071,426.25, as follows:

Distribution of 19,090 shares of stock at market value of $56.125 a share in satisfaction of dividend obligation	$1,071,426.25
Cost of stock distributed, $0.10 a share	1,909.00
Profit realized	$1,069,517.25

OPINION

ARUNDELL:

The respondent has determined that income was realized from the transactions detailed in the findings of fact and has asserted a tax thereon. His theory is that upon the declaration of the dividend on March 22, 1928, petitioner became indebted to its stockholders in the amount of $1,071,426.25, and that the discharge of that liability by the delivery of property costing less than the amount of the debt constituted income, citing Kirby Lumber Co. v. United States, 284 U. S. 1.

There are a number of decided cases somewhat similar to this, in some of which it has been held that the distributions resulted in gain or loss to the distributing corporation. See Callanan Road Improvement Co., 12 B. T. A. 1109; Bacon-McMillan Veneer Co., 20 B. T. A. 556. In those cases the dividend resolutions were construed as declaring dividends in definite amounts "*before* the property was distributed in kind." Bacon-McMillan Veneer Co., supra, p. 559. In this last cited case it was further said:

If, on the other hand, instead of providing for a definite [fol. 43] percentage in the way of a dividend, if the resolution had merely provided that the Liberty bonds should be distributed by way of dividends, a different situation would have been presented which is clearly distinguishable from the case we have before us.

A situation like that mentioned in the quotation just given was present in First Utah Savings Bank, 17 B. T. A. 804; affd., 53 Fed. (2d) 919. There the banking corporation owned the stock of another company, which stock was held by trustees, and the bank's directors by resolution directed the trustees "to deliver as a dividend" a designated number of shares of the stock. "No cash dividend had been declared by the bank as a part of this transaction." 53 Fed. (2d) 920. The stock at the time of distribution was worth less than cost. We held:

The Petitioner, by resolution of its board of directors, of October 17, 1922, only incurred an obligation to distribute the 9,000 shares of Amalgamated Sugar Co. stock to its stockholders, which obligation it fully discharged with-

out loss to it, by making the distribution of the stock as directed.

The facts in this case are somewhat analogous to those in Hollenberg Music Co., 6 B. T. A. 421, 425, wherein we said—referring to a dividend declared by the petitioner:

> • • • If, as the resolution of February 6, 1917 indicates, the petitioner merely distributed the property interest along with other dividends, we are unable to see that loss, contingent or otherwise, resulted from the distribution. • • •

The Court of Appeals of the District of Columbia in affirming our decision said:

> It is true that the rule hereby adopted leads to an anomalous result, inasmuch as appellant at the time of transferring the stock had suffered an actual loss of value measured by the difference between the cost of the transferred stock and its then market price, for which no deduction is allowed. But, on the other hand, according to the same rule if the transferred stock had enhanced in value between its pur- [fol. 44] chase and transfer no taxable gain would have been charged against the corporation because of that fact.

From the above cases the rule is deducible that, where the dividend resolution imposes only the obligation to distribute in kind and it is discharged in that way, no gain or loss results to the corporation. Counsel for respondent in his brief concedes this to be the correct view.

Our question then is to determine whether the resolution of March 22, 1928, was one declaring a dividend of an amount of money, or whether it declared a dividend payable in stock of the Islands Edison Company. The second paragraph of the resolution opens with the statement: "That a dividend in the amount of $1,071,426.25 be and it is hereby declared on the common stock of this Company • • •." The respondent would have us stop reading here. This, however, is only part of the resolution, and the part that immediately follows is of equal importance. The next clause limits as clearly as words can the medium of discharge of the dividend liability. Without separation by as much as a punctuation mark from the part of the

resolution just quoted, the words are: "payable in common stock of the Islands Edison Company • • •." Where the method of payment is prescribed a stockholder is not entitled to payment in some other form. In State v. B. & O. R. R., 6 Gill (Md.) 363, the railroad company had declared a dividend, payable in cash to holders of less than 50 shares, and payable part in cash and part in its own bonds to holders of 50 shares or more. The State of Maryland, being the owner of more than 50 shares, sued for a cash payment of the entire amount. The court denied recovery, saying in part:

It is immaterial in our view of the subject, whether the declaration of a dividend constitutes a contract, or is to be considered in the light of a performance of a duty. In either case, *it is to be taken as it emanates from the board. A part of it cannot be taken and the rest discarded.* It cannot be said you have declared three per cent. and we will have the money, although in the very declaration, they say they can only pay you in liabilities of the company. (P. 386.)

The intent of the directors of petitioner was to declare [fol. 45] a dividend payable in Islands Edison stock; their intent was expressed in that way in the resolution formally adopted; and the dividend was paid in the way intended and declared. We so construe the transaction, and on authority of First Utah Saving Bank, supra, we hold that the declaration and payment of the dividend resulted in no taxable income.

Reviewed by the Board.

Decision will be entered for the petitioner.

Black, Lansdon, Sternhagen, Murdock, Seawell, and Adams dissent.

BEFORE UNITED STATES BOARD OF TAX APPEALS,

Washington

Docket No. 52770

GENERAL UTILITIES AND OPERATING COMPANY, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

DECISION

Pursuant to the Board's findings of fact and opinion, promulgated January 30, 1934, it is

Ordered and decided that there is no deficiency in income tax for the calendar year 1928.

Enter.

(Signed) C. Rogers Arundell, Member, United States Board of Tax Appeals.

Entered Feb. 2, 1934.

[fol. 46] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

[Title omitted]

PETITION FOR REVIEW AND ASSIGNMENTS OF ERROR—Filed April 23, 1934

To the Honorable Judges of the United States Circuit Court of Appeals for the Fourth Circuit:

Comes now Guy T. Helvering, Commissioner of Internal Revenue, by his attorneys Frank J. Wideman, Assistant Attorney General, Robert H. Jackson, General Counsel, Bureau of Internal Revenue, and Paul E. Waring, Special Attorney, Bureau of Internal Revenue, and respectfully shows:

That he is the duly qualified and acting Commissioner of Internal Revenue holding his office by virtue of the laws of the United States; that the General Utilities and Operating Company, the respondent under review, hereinafter called the respondent, is a corporation existing under and by virtue of the laws of Delaware with its principal place of business

at Baltimore, Maryland; that the income tax return of the respondent for the year 1928, the period here involved, was filed with the Collector of Internal Revenue at Baltimore, Maryland, and that the office of said Collector is located within the jurisdiction of the said Circuit Court of Appeals for the Fourth Circuit.

The Commissioner of Internal Revenue determined a deficiency in income tax against the respondent for the calendar year 1928 of $128,342.07 and on December 16, 1930, sent to it by registered mail a notice of said deficiency in ac- [fol. 47] cordance with the provisions of Section 272 of the Revenue Act of 1928. Thereafter, on February 12, 1931, the respondent filed an appeal from said notice of deficiency with the United States Board of Tax Appeals.

On September 28, 1932, the case was submitted to the Board of Tax Appeals for its decision on an agreed statement of facts. The Board under date of April 24, 1933, promulgated its opinion and on April 27, 1933, entered its decision and order of redetermination in accordance with its opinion wherein and whereby it was ordered and decided that for the calendar year 1928 there is no deficiency in income tax due from the respondent.

On May 17, 1933, a motion was filed by the Government requesting the Board to recall its decision and grant a rehearing. Under date of May 26, 1933, the Board denied the motion but ordered that the report and determination under date of April 24, 1933, be recalled and the proceeding referred to Division No. 4 for consideration and report and further that the decision based on said report entered under date of April 27, 1933, be and the same is hereby vacated, set aside and made for naught.

The Board under date of January 30, 1934, promulgated another opinion and on February 2, 1934, entered its decision and order of redetermination in accordance with its last opinion wherein and whereby it was ordered and decided that for the calendar year 1928 there is no deficiency in income tax due from the petitioner.

The nature of the controversy is as follows, to-wit:

The only question to be decided is whether the petitioner realized taxable income in declaring a dividend and paying it in stock of another company at an agreed value per share, which value was in excess of the cost of the stock to the respondent.

The respondent is a Delaware corporation engaged in the business of owning securities, managing and operating public utility properties. On January 1, 1927, the respond- [fol. 48] ent acquired 20,000 shares of no par common stock of the Islands Edison Company at a cost of, to-wit, $2,000.00, and set up such stock on its books at a total value of $2,000.00. During January of 1928 Walter Whetstone, president of the Southern Cities Utilities Company became interested in acquiring control of the Santo Domingo Company, the stock of which was owned by the Islands Edison Company. Whetstone was informed by Lucas, president of the respondent, that if a sale of the 20,000 shares of the common stock of the Islands Edison Company, then owned by the respondent, were consummated, such a sale would be made only after the respondent had distributed the Islands Edison Company shares to its stockholders because they had been advised by their attorneys that if sale were made by the respondent, it would be subject to a tax on any profit realized on the sale and that when the proceeds of the sale were distributed to the stockholders, the stockholders would have to pay another tax thereon.

At a meeting of the respondent's directors on March 22, 1928, the matter of the respondent's stockholdings of the Island Edison Company was discussed and it was reported as the opinion of the respondent's officers that the stock was worth at least $1,122,500.00, and that it should be appreciated on the respondent's books to that figure. During that meeting a resolution was adopted, the important part of which was as follows:

"That a dividend in the amount of $1,071,426.25 be and it is hereby declared on the common stock of this company, payable in common stock of the Islands Edison Company at a valuation of $56.12½ a share, * * * payment of the dividend to be made by the delivery to the stockholders of this company pro rata, of certificates for the common stock of the Islands Edison Company held by this company at the rate of two shares of such stock for each share of common stock of this corporation. * * *"

Thereupon, on March 22, 1928, in accordance with the resolution of the directors, the respondent distributed to its stockholders 19,090 shares of the stock of the Islands Edison Company, such stock representing two shares of the Islands Edison Company stock theretofore owned by the

respondent for each common share of the 9,545 shares of re-
[fol. 49] spondent's own capital stock then outstanding. On March 26, 1928, the stockholders of the Islands Edison Company entered into a written contract for the sale of the Islands Edison Company stock.

The fair market value of the Islands Edison Company stock as of March 22, 1928 was $56.12½ per share.

The respondent's earned surplus from operations as of December 31, 1927, was $1,360,515.96, which amount was not impaired by operating losses prior to March 22, 1928. Such surplus and all the capital of the respondent at December 31, 1927, were invested at cost in the assets of the company, of which assets only $41,152.00 was cash. On March 22, 1928, the total cash of respondent was not more than $49,004.23.

The respondent received no cash or other property from the distribution of said 19,090 shares of the Islands Edison Company stock. The respondent in making its income tax return for the calendar year 1928 reported no income from the disposition of the 19,090 shares of the Islands Edison Company stock. The petitioner upon auditing the return held that the respondent corporation derived profit of $1,069,517.25 from the disposition thereof. The Government contended before the Board that under the terms of the declaration of the dividend on March 22, 1928, the respondent became indebted to its stockholders in the amount of $1,071,426.25 and that the discharge of that liability by delivery of property costing less than the amount of the debt, the difference between indebtedness liquidated and the cost of the property so delivered, constituted income to the respondent.

A Division of the Board of Tax Appeals in holding that the amount by which the $56.12½ a share was in excess of the cost did not constitute taxable income to the respondent, said:

"The intent of the directors of the petitioner was to declare a dividend payable in Islands Edison stock; their intent was expressed in that way in the resolution formally adopted; and the dividend was paid in the way intended and declared. We so construe the transaction, and on au-
[fol. 50] thority of First Utah Savings Bank, supra, (17 B. T. A. 804, affirmed 53 F. (2d) 919), we hold that the declaration and payment of the dividend resulted in no taxable income."

The petitioner's assignments of error are as follows, to-wit:

1. The Board of Tax Appeals erred in failing to hold and decide that under the terms of the declaration of the dividend on March 22, 1928, the respondent became indebted to its stockholders in the amount of $1,071,426.25 and that the discharge of that liability by delivery of property costing less than the amount of the debt, the difference between the indebtedness liquidated and the cost of the property so delivered, constituted income to the respondent.

2. The Board of Tax Appeals erred in holding and deciding that said dividend declaration was equivalent to the declaration of a dividend in kind, there being no evidence to sustain such holding.

3. The Board of Tax Appeals erred in failing to hold and decide that the respondent realized a taxable profit of $1,069,517.25 from the disposition of the Islands Edison Company stock in accordance with the terms of the dividend resolution in question.

4. The Board of Tax Appeals erred in holding and deciding that there was no deficiency in income tax for the year 1928 due from this respondent.

5. The Board of Tax Appeals erred in failing to hold and decide that there was a deficiency in income tax for the year 1928 due from this respondent of $128,342.07.

Wherefore, the Commissioner petitions that the decision of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Fourth Circuit, that a transcript of the record be prepared in accordance with the law and with the rules of said Court and transmitted to the Clerk of said Court for filing and that appropriate action be taken to the end that the errors complained [fol. 51] of may be reviewed and corrected by said Court.

(Sgd.) Frank J. Wideman, Assistant Attorney General. (Sgd.) Robert H. Jackson, General Counsel, Bureau of Internal Revenue. Of Counsel: Paul E. Waring, Special Attorney, Bureau of Internal Revenue.

Duly sworn to by Paul E. Waring. Jurat omitted in printing.

[fol. 52] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

[Title omitted]

NOTICE OF FILING PETITION FOR REVIEW—Filed April 27, 1934

To General Utilities and Operating Company, 1310 Standard Oil Building, Baltimore, Maryland:

You are hereby notified that the Commissioner of Internal Revenue did, on the 23rd day of April, 1934, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Fourth Circuit, of the decision of the Board heretofore rendered in the above-entitled case. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 23rd day of April, 1934.

(Signed) Robert H. Jackson, General Counsel, Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assign-
[fol. 53] ments of error mentioned therein, is hereby acknowledged this 24th day of April, 1934.

General Utilities & Op. Co., Respondent on Review.
J. C. M. Lucas, Prest.

Apr. 23, 1934.
PEW/HNP, 4-14-34.

IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

[Title omitted]

NOTICE OF FILING PETITION FOR REVIEW—Filed April 27, 1934

To Slaughter and Bickford, 815 15th Street, N. W., Washington, D. C.; Hugh C. Bickford:

You are hereby notified that the Commissioner of Internal Revenue did, on the 23rd day of April, 1934, file with

the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Fourth Circuit, of the decision of the Board heretofore rendered in the above-entitled case. A copy of the petition for review and the [fol. 54] assignments of error as filed is hereto attached and served upon you.

Dated this 23rd day of April, 1934.

(Sgd.) Robt. H. Jackson, General Counsel, Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of errors mentioned therein is hereby acknowledged this 23rd day of April, 1934.

(Sgd.) Hugh C. Bickford, Attorney for Respondent on Review.

IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

[Title omitted]

PRÆCIPE FOR RECORD—Filed June 15, 1934

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Fourth Circuit, copies duly certified as correct of the following documents and records in the above-entitled cause in connection with the petition for review by the said Circuit Court of Appeals for the Fourth Circuit, heretofore filed by the Commissioner of Internal Revenue:

[fol. 55] 1. Docket entries of the proceedings before the Board.

2. Pleadings before the Board.

(a) Petition, including annexed copy of deficiency letter.

(b) Answer.

3. Stipulation of facts, together with all exhibits attached thereto. (A to E sent up in original form.)

4. Findings of fact, opinion and decision of the Board promulgated April 24, 1933.

5. Motion for rehearing filed May 17, 1933.

6. Order entered May 26, 1933, vacating and setting aside decision of the Board dated April 27, 1933.

7. Findings of fact, opinion and decision of the Board promulgated January 30, 1934.

8. Petition for review, together with proof of service of notice of filing petition for review and service of a copy of petition for review.

9. This præcipe.

(Signed) Robert H. Jackson, General Counsel, Bureau of Internal Revenue.

Service of a copy of the within præcipe is hereby admitted this 3 day of May, 1934.

(Sgd.) R. Kemp Slaughter, Attorney for Respondent.

PEW/HNP, 5-2-34.

[fol. 56] Clerk's certificate to foregoing transcript omitted in printing.

[fols. 57 & 58] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

[Title omitted]

ORDER AS TO ORIGINAL EXHIBITS

Upon consideration of the joint motion filed by the parties herein on the 16th day of July, 1934, it is this 17th day of July, 1934,

Ordered that the documents, consisting of Exhibits A, B, C, D and E of the written stipulation of facts filed with the United States Board of Tax Appeals at the hearing of this proceeding, may be transmitted to this Court as original documents comprising a part of the record and that the Clerk of this Court retain custody thereof for the use of the Court and counsel at the hearing of this proceeding.

John J. Parker, Senior Circuit Judge.

[fol. 59] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 3720

GUY T. HELVERING, Commissioner of Internal Revenue, Petitioner,

versus

GENERAL UTILITIES AND OPERATING COMPANY, Respondent

On Petition to Review the Decision of the United States Board of Tax Appeals

DOCKET ENTRIES

July 21, 1934, the transcript of record is filed and the cause docketed.

Same day, certified copy of order enlarging time to July 31, 1934, for the transmission and delivery of the transcript of record is filed.

Same day, the appearance of Frank J. Wideman, Assistant Attorney General, and Sewall Key, Special Assistant, Attorney General, is entered for the petitioner.

IN UNITED STATES CIRCUIT COURT OF APPEALS

MOTION AS TO ORIGINAL EXHIBITS A, B, C, D AND E—Filed July 16, 1934

Come now Guy T. Helvering, Commissioner of Internal Revenue, and the General Utilities and Operating Company, by their respective counsel, and respectfully show [fol. 60] that on April 23, 1934, the petitioner, the aforesaid Commissioner of Internal Revenue, filed with the Clerk of the U. S. Board of Tax Appeals his petition for review of decision entered by the Board of Tax Appeals on February 2, 1934. Præcipe was filed on June 15, 1934, for the preparation of the record. In the trial before the Board the entire evidence was submitted by written stipulation of facts to which was attached a number of exhibits including A, B, C, D and E. Said exhibits, A, B, C and D, consist of photo-

static copies of a large number of stock certificates which it is impossible to reproduce in the printed record, while exhibit E is a photostatic copy of an original contract involved in this proceeding. Said exhibits could only be reproduced in photostatic form at great expense.

Wherefore the parties respectfully move that permission be granted to send said original photostats, comprising said exhibits, to this Court as a part of the record and that the Court enter its order accordingly.

Robert H. Jackson, Assistant General Counsel for the Bureau of Internal Revenue. Hugh C. Bickford, Attorney for Respondent.

ORDER AS TO ORIGINAL EXHIBITS

Filed July 17, 1934

(Note: This order is printed at page 57 and is, therefore, omitted here.)

IN UNITED STATES CIRCUIT COURT OF APPEALS

DOCKET ENTRIES

July 21, 1934, original exhibits A, B, C, D and E are certified up.

July 25, 1934, the appearance of R. Kemp Slaughter and Hugh C. Bickford is entered for the respondent.

July 27, 1934, the appearance of Robert H. Jackson, Assistant General Counsel for the Bureau of Internal Reve- [fol. 61] nue, and William E. Davis, Special Attorney for the Bureau of Internal Revenue, is entered for the petitioner.

August 22, 1934, twenty-five copies of the printed record are filed.

October 19, 1934, the appearance of Norman D. Keller, Special Assistant to the Attorney General, is entered for the petitioner.

Argument of Cause

November 22, 1934, (October term, 1934,) cause came on to be heard before Parker, Northcott and Soper, Circuit Judges and is argued by counsel and submitted.

December 11, 1934, motion of respondent for leave to file supplemental brief is filed.

IN UNITED STATES CIRCUIT COURT OF APPEALS

ORDER ALLOWING FILING OF SUPPLEMENTAL BRIEF—Filed December 11, 1934

Upon motion filed by the respondent herein, and for good cause shown,

It is ordered that permission is granted respondent to file the supplemental brief on behalf of respondent submitted with respondent's motion.

It is further ordered that the petitioner be granted 10 days within which to file reply to the same.

John J. Parker, Senior Circuit Judge.

[fol. 62] IN UNITED STATES CIRCUIT COURT OF APPEALS, FOURTH CIRCUIT

No. 3720

GUY T. HELVERING, Commissioner of Internal Revenue, Petitioner,

versus

GENERAL UTILITIES AND OPERATING COMPANY, Respondent

On Petition to Review the Decision of the United States Board of Tax Appeals

(Argued November 22, 1934. Decided January 8, 1935)

Before Parker, Northcott, and Soper, Circuit Judges

Norman D. Keller, Special Assistant to the Attorney General, (Frank J. Wideman, Assistant Attorney General, and Sewall Key, Special Assistant to the Attorney General, on brief) for Petitioner, and Hugh C. Bickford (R. Kemp Slaughter and Joseph A. Slattery, on brief) for Respondent.

OPINION—Filed January 8, 1935

NORTHCOTT, Circuit Judge:

This is a petition to review a decision of the United States Board of Tax Appeals involving income tax of the

[fol. 63] respondent for the calendar year 1928 in the sum of $128,342.07. The opinion of the Board of Tax Appeals will be found in 29 B. T. A. 934.

The facts were stipulated and the Board set aside a finding of deficiency made by the Commissioner of Internal Revenue in the above named amount and the Commissioner filed this petition to review the action of the Board.

The respondent is a Delaware corporation, with its principal offices at Baltimore, Maryland. It is engaged in the business of owning securities of, managing, and operating public utility properties.

On January 1, 1927, the respondent acquired 20,000 shares of no par value of the common capital stock of another corporation, the Islands Edison Company. Said 20,000 shares of stock constituted one-half of the total common capital stock of said Islands Edison Company outstanding; the remaining 20,000 shares were owned by Gillet & Company, which company is not connected with respondent nor with respondent's stockholders. Respondent acquired said 20,000 shares of common capital stock of the Islands Edison Company at a cost to it of $2,000.00 and set up such stock on its books at a total value of $2,000.

During the month of January, 1928, Walter Whetstone, president of the Southern Cities Utilities Company, became interested in acquiring control of a Santo Domingo company, the stock of which was owned by the Islands Edison Company. Upon inquiring of Gillet & Company Whetstone ascertained that the entire common stock outstanding of the Islands Edison Company was owned equally by Gillet & Company and respondent. In a conference with J. C. M. Lucas, president of respondent, Whetstone discussed the purchase of the Santo Domingo Company or the Islands Edison Company common stock and as a result thereof was given permission to make an investigation of the properties of the Santo Domingo Company. Sometime in February, 1928, Whetstone informed Gillet and Lucas that his plans required the delivery of all the common stock of the Islands Edison Company, and he was informed by Gillet that his firm was ready and willing to make the sale of the 20,000 shares, owned by Gillet & Company, of the Islands Edison Company common stock and that he (Gillet) and Lucas, [fol. 64] president of respondent, had agreed upon the price at which the sale would be made. Whetstone was informed

by Lucas that if a sale of the 20,000 shares of the common stock of the Islands Edison Company then owned by the respondent were consummated such a sale would be made only after respondent had distributed the Islands Edison Company shares to its stockholders, because they had been advised by their attorneys that if sale were made by respondent it would be subject to a tax on any profit realized on the sale and that when the proceeds of the sale were distributed to the stockholders, the stockholders would have to pay another tax thereon. The price to be paid for the properties and generally the terms and conditions of the sale were agreed upon by Gillet, Lucas, and Whetstone, but no contract was entered into by them, it being understood and agreed between them that respondent would make distribution of the stock of the Islands Edison Company to its stockholders and that counsel would prepare a written agreement embodying the terms and conditions of the said sale, said agreement to be submitted for approval to the stockholders of the Islands Edison Company after the distribution of said stock by the respondent. Lucas never held power of attorney to sell said stock for the respondent or its stockholders.

At a meeting of respondent's directors on March 22, 1928, the matter of respondent's stockholdings in the Islands Edison Company was discussed and it was reported as the opinion of respondent's officers that the stock was worth at least $1,120,500.00 and that it should be appreciated on respondent's books to that figure. Further matters discussed and action taken at that meeting are recorded in the minutes as follows:

"The chairman also suggested to the meeting that the Company considered declaring a dividend on the Common Stock of the Company in the amount of $1,071,426.25, payable out of the appreciation so set up, the dividends to be paid in Common Stock of the Islands Edison Company at a value of $56.12½ a share.

Whereupon the following resolutions were unanimously passed, viz:

[fol. 65] (a) that this Company appreciate on its books, its holdings of Common Stock of the Islands Edison Company in the amount of 20,000 shares in the amount of $1,-

120,500.00 and that the amount of this appreciation be credited to surplus arising from appreciation of assets;

(b) that a dividend in the amount of $1,071,426.25 be and is hereby declared on the Common Stock of this Company payable in Common Stock of the Islands Edison Company at a valuation of $56.12½ a share, out of the surplus of the Company arising from the appreciation in the value of the Common Stock of the Islands Edison Company held by this Company, viz, $1,120,500.00, the payment of this dividend to be made by the delivery to the stockholders of this Company pro rata, of certificates for the Common Stock of the Islands Edison Company held by this Company at the rate of two shares of such stock for each share of Company Stock of this Corporation; the stockholders entitled to be those of record at the close of business this day.

There being no further business before the meeting it then adjourned."

The respondent thereupon, on March 22, 1928, simultaneously entered on its books of account, in compliance with the foregoing resolution, the following entries, with full explanation following each entry, only part of which is here set forth:

1928		Dr.	Cr.
March 22.	Investments	$1,120,500.00	
	Surplus arising from appreciation of assets		$1,120,500.00
March 22.	Surplus arising from appreciation of assets	1,071,426.25	
	Dividends payable		1,071,426.25
	To record dividend declared on the Common Stock of the Company, payable in Common Stock of The Islands Edison Company at a valuation of $56.12½ a share, * * *		
March 22.	Dividends payable	1,071,426.25	
	Investments		1,071,426.25
[fol. 66]	To record payment of dividends declared March 22, 1928, on the Common Stock of this Company, such payment being made by delivery of 19,090 shares of the Common Stock of The Islands Edison Company at a valuation of $56.12½ per share.		

Thereupon, on March 22, 1928, in accordance with the resolution of the directors the respondent distributed to its own stockholders, 19,090 shares of the stock of the

Islands Edison Company, such shares representing two shares of the Islands Edison Company stock theretofore owned by respondent for each one share of the 9,545 shares of respondent's own capital stock then outstanding. On the same date, March 22, 1928, the shares of stock were transferred on the stock records of the Islands Edison Company to the individuals receiving the distribution. After transfer of the 19,090 shares, there remained in the hands of respondent 910 shares of stock of the Islands Edison Company, which 910 shares were retained by it and a new certifi- [fol. 67] cate for such shares was issued to it on March 22, 1928.

On March 26, 1928, the stockholders of the Islands Edison Company (one of which was the respondent, owning 910 shares) and the Southern Cities Utilities Company, entered into a written contract of sale of the Islands Edison Company stock. At no time did respondent agree with Whetstone or the Southern Cities Utilities Company, verbally or in writing, to make sale to him or to the Southern Cities Utilities Company of any of said stock except the aforesaid 910 shares of the Islands Edison Company.

The fair market value of the Islands Edison Company stock as of March 22, 1928, was $56.12½ per share, said amount being computed in the contract dated March 26, 1928, as follows:

"Total sales price	$3,375,000
Less: Liability for bonds and preferred stock outstanding	1,130,000
Net consideration for stock	$2,245,000"

The net consideration, $2,245,000, divided by the number of shares, 40,000, gives a quotient of $56.12½ per share.

Respondent's earned surplus from operations as of December 31, 1927, was $1,360,515.96, which amount was not impaired by operating losses prior to March 22, 1928. Such surplus and all the capital of the respondent at December 31, 1927, were invested at cost in assets of the company, of which assets only $41,152.00 was cash. On March 22, 1928, the total cash of respondent was not more than $49,004.23.

The 910 shares of the Islands Edison Company common stock which were retained by the respondent after the distribution of 19,090 shares to its stockholders on March 22, 1928, were sold to the Southern Cities Utilities Company on

May 14, 1928, and a profit of $46,346.30 was reported on the 1928 return filed by the respondent, computed as follows:

[fol. 68] "Sale price of 910 shares at $51.25 per share $46,437.30
Cost of 910 shares at 10¢ per share 91.00

Profit reported in return ..... $46,346.30"

The difference between the amount of $56.12½ per share, set forth above as the price stated in the contract of March 26, 1928, and the amount of $51.25 as shown in this paragraph as the amount received on May 14, 1928, when sale was made, is represented by brokerage charges, commissions and other expenses incident to the consummation of the sale which were charged against the stockholders in accordance with the provisions of the contract.

The respondent received no cash or other property for the distribution of said 19,090 shares of the Islands Edison Company common stock.

Respondent, in making its income tax return for the calendar year 1928, reported no income from the disposition of the 19,090 shares of the Islands Edison common stock. The petitioner upon auditing the return, has held that the respondent corporation derived a profit of $1,069,517.25 from the disposition thereof, the explanation in the notice of deficiency being in part as follows:

"It is therefore held that your corporation realized a taxable gain of $1,069,517.25 upon the distribution of The Islands Edison Company stock in payment of the dividend of $1,071,426.25, as follows:

"Distribution of 19,090 shares of stock at market value of $56.125 a share in satisfaction of dividend obligation $1,071,426.25
Cost of stock distributed, $0.10 a share 1,909.00

Profit realized $1,069,517.25

There are two grounds upon which the petitioner urges that the action of the Board of Tax Appeals was wrong: First, that the dividend declared was in effect a cash divi- [fol. 69] dend and that the respondent realized a taxable income by the distribution of the Islands Edison Company stock to its stockholders equal to the difference between the

amount of the dividend declared and the cost of the stock; second, that the sale made of the Islands Edison Company stock was in reality a sale by the respondent (with all the terms agreed upon before the declaration of the dividend), through its stockholders who were virtually acting as agents of the respondent, the real vendor.

As to the first contention we are of the opinion that the action of the Board of Tax Appeals was correct. The resolutions of the board of directors of the respondent declaring the dividend, is capable of only one interpretation, that the dividend was payable not in cash but in the common stock of the Islands Edison Company. Under this resolution the stockholders could not, in the event of the failure to deliver the stock of the Islands Edison Company, have had the right to recover an equal amount of cash. In the case of The State of Maryland v. Balt. & Ohio R. R. Company, 6 Gill 363, a discussion will be found as to a dividend declared under a resolution analogous to the one here in question and in that case a conclusion was reached similar to that reached by us here.

As to the second point raised by the petitioner, it is contended on behalf of the respondent that this point, not having been raised before the Board, cannot now be urged before us for the first time. We cannot agree with this conclusion. The correctness of the result reached by the Commissioner of Internal Revenue in determining the deficiency is the controlling factor and not the method by which it was determined nor the reasons given for the determination.

Hughes v. Commissioner, 38 Fed. (2) 755.
Hurwitz v. Commissioner, 45 Fed. (2) 780.
Helvering v. Gregory, 69 Fed. (2) 809.

Where all of the facts are before the Board of Tax Appeals it may pass upon the correctness of the Commissioner's final determination (Christopher v. Burnet, 55 Fed. (2) 527). Here the facts are undisputed and the questions [fol. 70] presented are purely questions of law upon the admitted facts. We are also of the opinion that the issue first raised on appeal before us can be considered if "justice so requires". As was said by Judge Parker of this court in Virginia Lincoln Furniture Corporation v. Commissioner, 56 Fed. (2) 1028:

"In addition to this, it appears from the record that petitioner is entitled to relief; and we will not turn him out of

court because he may have misconceived his remedy. As we have said before, courts exist to do justice, not to furnish a forum for the technical skill of counsel. In reviewing a decision of the Board, we are given broad powers to affirm, modify, or reverse it 'as justice may require' (26 U. S. C. A., Sec. 1226); and we do not think that justice requires that a petitioner with a meritorious case be turned out of court upon any such technical ground. See Underwood v. Commissioner (C. C. A. 4th) 56 F. (2d) 67.

See, also:

Hurwitz v. Commissioner, supra.
Superheater Co. v. Commissioner, 38 F. (2) 69.
Seufert Bros. Co. v. Lucas, 44 F. (2) 528.
Commissioner v. Norfolk Southern R. Co., 63 F. (2) 304.

The reason for the rule, sometimes enforced by the courts, that an appellate court will confine itself to the issue presented and ruled upon by the court below, is based on the ground that the opposing party has no opportunity to resist the new issue by amendment of the pleadings or by additional proof. No such conditions exist here. No amendment to the pleadings is required to settle the issue here discussed and no additional evidence could change the stipulated fact. Under the broad powers given us to review decisions of the Board we have the power to pass on the question raised if the requirements of justice demand it. No good purpose could possibly be served by remanding the case to the Board for a further decision on a point that can be decided here on the stipulated facts.

The respondent was not taken by surprise by the raising [fol. 71] of this question. It was discussed in the brief, on behalf of petitioner, filed October 19, 1934, and replied to in detail in the brief on behalf of respondent, filed November 10, 1934, prior to the oral argument before us.

When we come to consider the sale of the stock of the Island Edison Company we cannot escape the conclusion that the transaction was deliberately planned and carried out for the sole purpose of escaping taxation. The purchaser was found by the officers of the respondent; the exact terms of the sale as finally consummated were agreed to by the same officers; the purchaser of the stock stated that the delivery of all the stock was essential and that the delivery of a part thereof would not suffice; the details

were worked out for the express and admitted purpose of avoiding the payment of the tax and for the reason that the attorneys for the respondent had advised that unless some such plan was adopted the tax would have to be paid; and a written agreement was to be prepared by counsel for the respondent which was to be submitted to the stockholders; all this without the stockholders, or any of them, who were ostensibly making the sale, being informed, advised or consulted. Such admitted facts plainly constituted a plan, not to use the harsher terms of scheme, artifice or conspiracy, to evade the payment of the tax. For the purposes of this decision it is not necessary to consider whether such a course as is here shown constituted a fraud, it is sufficient if we conclude that the object was to evade the payment of a tax justly due the government.

The sale of the stock in question was, in substance, made by the respondent company, through the stockholders as agents or conduits through whom the transfer of the title was effected. The stockholders, even in their character as agents, had little or no option in the matter and in no sense exercised any independent judgment. They automatically ratified the agreement prepared and submitted to them.

Where a plan of action is proven the courts will consider it as a whole rather than divide it into independent steps "Two steps in a single transaction" cannot be treated as two transactions. (Prairie Oil & Gas Co. v. Motter, 66 Fed. (2) 309; West Texas Refining & D. Co. v. Commissioner, 68 Fed. (2) 77.)

In matters of taxation the substance rather than the [fol. 72] form of the transaction will be regarded. (U. S. v. Phellis, 257 U. S. 156, and authorities there cited.)

In substance the transaction here involved was a sale of the stock of the Islands Edison Company by the respondent. Anticipatory arrangements, intended to circumvent the taxing statutes, are not looked upon with favor by the courts. As was said in MacQueen Co. v. Commissioner, 67 Fed. (2) 857:

"The principle that substance and not form should control in the application of income tax laws (United States v. Phellis, 257 U. S. 156; Labrot v. Burnet, 57 Fed. (2) 413; Reed v. United States, 51 F. (2d) 941) may be invoked in the instant case. Although in form there were two sales

of the corporate real estate, first, the purported sale by the petitioner to MacQueen, and, second, the sale by MacQueen to Hatfield, in substance the transaction was a sale by the petitioner to Hatfield through the agency of MacQueen. So also, although in form MacQueen was a trustee for the distribution of the profits earned by the sale of his own real estate to Hatfield, in substance he was the agent of the petitioner for the distribution of the profits from the sale of the corporation's real estate among its stockholders.

The corporate tax rate imposed by the applicable taxing statutes is higher than the individual rate. The obvious purpose of the procedure followed by the petitioner, its directors, and stockholders, was to take advantage of the lower tax rate permitted individuals and thereby avoid the corporate tax rate on the profits of the ultimate sale of the real estate. Such anticipatory arrangements and contracts, intended to circumvent the taxing statutes, are not looked upon with favor. Lucas v. Earl, 281 U. S. 111; Phelps v. Commissioner, 54 F. (2d) 289, certiorari denied, 285 U. S. 558."

The decision of the Board of Tax Appeals is reversed and the cause is remanded for further proceedings in accordance with this opinion.

Reversed.

[fols. 73 & 74] IN UNITED STATES CIRC[illegible] COURT OF APPEALS,
FOURTH CIRCUIT

No. 3720

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

vs.

GENERAL UTILITIES AND OPERATING COMPANY, Respondent

On Petition to Review the Decision of the United States Board of Tax Appeals

JUDGMENT—Filed and Entered January 9, 1935

This cause came on to be heard on the transcript of the record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof it is now here ordered and adjudged by this Court that the decision of the said Board of Tax Appeals, in this cause, be, and the same is hereby, reversed; and that this cause be, and the same is hereby, remanded to the United States Board of Tax Appeals for further proceedings in accordance with the opinion of the Court filed herein.

Elliott Northcott, U. S. Circuit Judge.

January 9, 1935.

[fols. 75-132] Petition for rehearing, covering 57 pages, filed Feb. 6, 1935, omitted from this print. It was denied and nothing more by order of April 2, 1935.

[fol. 133] February 6, 1935, application of respondent for a stay of the mandate is filed.

IN UNITED STATES CIRCUIT COURT OF APPEALS

ORDER STAYING MANDATE PENDING PETITION FOR A REHEARING—Filed February 6, 1935.

Upon consideration of the application of respondent for a stay of mandate and it appearing that the respondent has this day presented a petition for a rehearing in the above entitled case,

It is ordered that the mandate of this Court in this case be, and the same is hereby, stayed pending the action of the Court on said petition for rehearing.

John J. Parker, Senior Circuit Judge.

February 6, 1935.

IN UNITED STATES CIRCUIT COURT OF APPEALS, FOURTH CIRCUIT

[Title omitted]

ORDER DENYING REHEARING—Filed and Entered April 2, 1935

[fol. 134] This Court having at its January term, 1935, rendered its decision reversing the decision of the said

United States Board of Tax Appeals in this cause, and the respondent having on February 6, 1935, presented to the Court a petition for a rehearing of the said cause, and the same having been carefully considered,

It is now here ordered by this Court that the rehearing asked for, be, and the same is hereby, denied. Let mandate issue after the expiration of five days from this date.

John J. Parker, Senior Circuit Judge.

April 2, 1935.

April 4, 1935, application of respondent for a stay of the mandate is filed.

IN UNITED STATES CIRCUIT COURT OF APPEALS

ORDER STAYING MANDATE PENDING APPLICATION OF RESPONDENT FOR A WRIT OF CERTIORARI—Filed April 4, 1935

Upon consideration of the application of respondent for a stay of mandate and it appearing that the respondent desires to file with the Supreme Court of the United States petition for writ of certiorari in the above entitled case,

It is ordered that the mandate of this Court in this case be, and the same is hereby, stayed pending the action of the Supreme Court of the United States on petition for writ of certiorari, provided application for certiorari is made within thirty days of this date.

John J. Parker, Senior Circuit Judge.

April 4, 1935.

[fol. 135] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 136] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed June 3, 1935

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Fourth Circuit is granted. And it is further ordered that the duly

certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Endorsed on cover: File No. 39,567. U. S. Circuit Court of Appeals, Fourth Circuit. Term No. 41. General Utilities and Operating Company, Petitioner, vs. Guy T. Helvering, Commissioner of Internal Revenue. Petition for a writ of certiorari and exhibit thereto. Filed May 3, 1935. File No. 41, O. T., 1935.

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1934

No. 936 41

GENERAL UTILITIES & OPERATING COMPANY,
Petitioner,

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS, FOURTH CIRCUIT.

R. KEMP SLAUGHTER,
HUGH C. BICKFORD,
JOSEPH A. SLATTERY,
Counsel for Petitioner.

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1934

No.

GENERAL UTILITIES & OPERATING COMPANY,
Petitioner,

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Petitioner.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS, FOURTH CIRCUIT.

This is a petition for writ of certiorari to the United States Circuit Court of Appeals, Fourth Circuit, involving a decision by that Court in the case of *Guy T. Helvering, Commissioner,* v. *General Utilities & Operating Company, Respondent,* No. 3720, reported at 74 (2d) 972, wherein the Court reversed a decision of the U. S. Board of Tax Appeals, 29 B. T. A. No. 165. On application of respondent the Court, on February 6, 1935, entered an order staying the mandate of the Court pending action by the Court on

a petition for rehearing. Petition for rehearing was filed on that date and on April 2, 1935, the petition was denied. (R. 133.)

Questions Presented.

The case presents the following questions:

1. Did the U. S. Circuit Court of Appeals, in reversing the U. S. Board of Tax Appeals, err in holding that petitioner derived taxable profit from the sale of certain common capital stock of the Islands Edison Company by its thirty-three stockholders who had received the said stock at an appreciated fair market value through a dividend distribution duly authorized and made by the petitioner?

2. Did the Circuit Court of Appeals err in rendering opinions on facts not found by the Board of Tax Appeals but for the first time presented on appellate brief of petitioner below.

Summary Statement of the Matter Involved.

The evidence in the case, submitted in written stipulation (R. 11-21), may be summarized as follows:

The petitioner is a Delaware corporation with its principal offices at Baltimore, Maryland. It is engaged in the business of owning securities of, managing and operating public utilities properties.

On January 1, 1927, the petitioner acquired 20,000 shares of no par value of the common capital stock of the Islands Edison Company. The remaining outstanding 20,000 shares of stock of this company were owned by Gillett & Company, which is not connected with petitioner nor with petitioner's stockholders. The cost to petitioner of its 20,000 shares of common capital stock of the Islands Edison Company was $2,000.

In January, 1928, Walter Whetstone, President of the Southern Cities Utilities Company, became interested in acquiring this Islands Edison Company stock. Upon inquiry and after conversations with J. C. M. Lucas, President of the petitioner, and Gillett, of Gillett & Company, a price was agreed upon for the sale of all the Islands Edison Company stock to Southern Cities Utilities Company. Whetstone was informed by Lucas that if a sale of the 20,000 shares of the common stock of Islands Edison Company then owned by petitioner were consummated, such a sale would be made only after petitioner had distributed the Islands Edison Company shares to its stockholders, because attorneys had advised that if sale were made by petitioner it would be subject to a profit tax and that when the proceeds of the sale were distributed to the stockholders the stockholders would have to pay another tax. The price to be paid for the properties and generally the terms and conditions of the sale were agreed upon by Gillett, Lucas and Whetstone, but no contract was entered into by them. Lucas did not hold power of attorney to sell said stock for the petitioner or its stockholders. It was understood and agreed that petitioner would make distribution of the stock of the Islands Edison Company to its stockholders and that counsel would prepare a written agreement embodying the terms and conditions of the said sale, to be submitted for approval to the stockholders of the Islands Edison Company after the distribution of the stock by the petitioner.

On March 22, 1928, the petitioner's directors gave consideration to the then value of the stock of the Islands Edison Company and authorized, by proper resolution, that an entry be made on the books of the petitioner crediting its surplus in the amount of $1,120,500 to represent the appreciated value of the stock. Thereupon a dividend in the amount of $1,071,426.25 was declared on the common stock

of the petitioner, payable out of this appreciated surplus in common stock of the Islands Edison Company at a valuation of $56.12½ a share.

On March 22, 1928, in accordance with the resolution of the directors, the petitioner distributed to its own stockholders 19,090 shares of the stock of the Islands Edison Company, such shares representing two shares of the Islands Edison Company stock theretofore owned by petitioner for each share of the 9,545 shares of petitioner's own capital stock then outstanding. On the same date the shares of stock were transferred on the stock records of the Islands Edison Company to the individuals receiving the distribution. After the transfer of the 19,090 shares by dividend distribution there remained in the hands of the petitioner 910 shares of stock of the Islands Edison Company and a new certificate for such shares was issued to it on March 22, 1928.

On March 26, 1928, the stockholders of the Islands Edison Company (one of which was the petitioner, owning 910 shares) and the Southern Cities Utilities Company, entered into a written contract of sale of the Islands Edison Company stock. At no time did petitioner agree with Whetstone or the Southern Cities Utilities Company, verbally or in writing, to make sale to him or to the Southern Cities Utilities Company of any of said stock except the aforesaid 910 shares of the Islands Edison Company stock.

The 910 shares of the Islands Edison Company stock were sold by petitioner to the Southern Cities Utilities Company on May 14, 1928, and a profit of $46,346.30 was reported on the 1928 tax return filed by the petitioner. The sales price was $51.25 per share, which resulted in the aforesaid profit after deducting the cost of 910 shares at 10¢ per share. Certain brokerage charges, commissions and other expenses which were charged against the stockholders in accordance with the contract of sale, had reduced

the share value of $56.12½ for the stock at date of dividend distribution to $51.25 per share at date of sale.

Although petitioner received no cash or other property in the dividend distribution of 19,090 shares of stock, the respondent upon auditing the return of the petitioner held that it derived a profit of $1,069,517.25 from the dividend distribution. This was determined by deducting $1,909, the cost of the 19,090 shares distributed to the stockholders from the market value of the stock at $56.12½ per share.

On this alleged profit the respondent asserted a deficiency against petitioner in the amount of $128,342.07; appeal was taken to the U. S. Board of Tax Appeals on the theory of the respondent that

> "upon the declaration of the dividend on March 22, 1928 petitioner became indebted to its stockholders in the amount of $1,070,426.25 and that the discharge of that liability by the delivery of property costing less than the amount of the debt, constituted income."

On April 24, 1933, a division of the Board rendered opinion that

> "the intent of the directors of petitioner was to declare a dividend payable in Islands Edison stock; their intent was expressed in that way in the resolution formally adopted; and the dividend was paid in the way intended and declared. We so construe the transaction and on authority of *First Utah Savings Bank, supra,* we hold that the declaration and payment of the dividend resulted in no taxable income."

This opinion on order of the Chairman of the Board was reviewed by the full Board which approved the opinion, six members dissenting.

Appeal was taken by the respondent and the Circuit Court, while holding that a dividend distribution of stock had been made by petitioner, decided there was a plan to

avoid payment of the tax by petitioner and that the subsequent sale of the stock by the thirty-three stockholders was "in substance" a sale by the petitioner.

Reasons Relied Upon for Allowance of the Writ.

1. The decision of the court reversing the U. S. Board of Tax Appeals is in conflict with decisions of this Court and decisions of the Circuit Courts.

It is established by decisions of this Court that "the legal right of a taxpayer to decrease the amount of what otherwise would be his taxes or altogether avoid them by means which the law permits cannot be doubted." *Gregory* v. *Helvering,* decided by this Court January 7, 1935, just one day prior to the decision of the Circuit Court of Appeals in this proceeding. *U. S.* v. *Isham,* 17 Wall. 496, 506; *Superior Oil Company* v. *Miss.,* 280 U. S. 390, 395-6. The decision is in direct conflict with *Jones* v. *Helvering,* 71 F. (2d) 214, 217 (Ct. App. D. C.), cited with approval by this Court in *Gregory* v. *Helvering, supra.* The Court below held in this appeal that

> "Such admitted facts plainly constituted a plan, not to use the harsher terms of scheme, artifice or conspiracy, to evade the payment of the tax. For the purpose of this decision it is not necessary to consider whether such a course as is here shown constituted a fraud, it is sufficient if we conclude that the object was to evade the payment of a tax justly due the Government."

2. The decision ignores the separate entities of the corporation and its stockholders, and is in conflict with decisions of this Court, Eisner v. Macomber, 252 U. S. 189; it is contrary to well recognized principles of corporate law, 7 R. C. L. at par. 270, 281; it is contrary to the intent of the Revenue Act and the Treasury Regulations thereunder. Section 115 of the Revenue Act of 1928, Article 627 of T. D. 74, applicable to the Revenue Act of 1928.

It seems to be well settled that where a dividend has been fully declared the corporation thereby manifests its intention that the amount of the dividend should be considered as having been separated from the other property of the corporation and as having become the individual property of the stockholders and that, therefore, when the dividend becomes payable according to the terms of the vote declaring it, each stockholder has a right to demand payment of the proportional part of the dividend which belongs to his share of stock and to sue the corporation for it if it is not paid on demand. (See also *State of Maryland* v. *Baltimore & Ohio R. R. Co.*, 6 Gill. 363.)

It is also a general rule of law that a corporation has a personality of its own distinct from its stockholders and that it is not affected by contracts made directly or by its stockholders with third persons, whether they own much or little of its capital stock. *Sellers* v. *Grier*, 172 Ill. 549, 50 N. E. 246, 4 L. R. A. 589; *Harris* v. *Muskingam Mfg. Co.*, 4 Blackf. (Ind.) 267, 29 Am. Dec. 372; *Fitzpatrick* v. *O'Neill*, 43 Mont. 552, 118 Pac. 273; *Eisner* v. *Macomber*, *supra*; *New Colonial Ice Co. Inc.* v. *Helvering*, 292 U. S. 435.

The regulations of the Treasury Department, Article 627 *supra* recognizes that a corporation may elect to distribute property in kind to its stockholders instead of effecting realization by sale. When a dividend distribution of prop-

erty is made by a corporation, it is taxed as income to the stockholder to the amount of the fair market value of the property when received by the shareholder. This was the effect of the decision of the Board in this case and the distribution of this stock of substantial value necessarily imposed on the recipients high taxes under the surtax brackets.

The decision below, on the contrary, holds that the thirty-three stockholders were the same entity as the corporation, a holding which completely destroys the concept of corporate entity.

3. The decision is contrary to the basis of loss or gain provided for in the Revenue Act of 1928—Sections 111, 112 and 113.

The sale of this Islands Edison stock was made by the individual owners, under full legal title. The stock having been taxed to owners at fair market value when received and having been sold by them at less than fair market value they really suffered a loss in the sale. The decision of the court below imposes a tax on the corporation through a sale "in substance" by it, although the basis of the sale under the decision was not the actual selling price of $51.25 for the stock but its fair market value of $56.12½ which is the same value on which the stockholders have been assessed for taxes under Article 627 *supra*. The actual selling price of $51.25 realized by the stockholders has not been considered.

4. The decision raises an important question as to the jurisdiction of the Circuit Court of Appeals to decide a question of fact not raised before the Board of Tax Appeals.

It is of great importance that this Court pass upon the question whether the Circuit Courts of Appeals have juris-

diction to consider new questions not raised before the Board of Tax Appeals, and not covered by the petition for review nor by an assignment of error. Particularly is this so as to questions involving facts contrary to the stipulated facts. In the lower courts and in the profession there exists great doubt as to the extent of the jurisdiction of the courts to consider such questions, which doubt should be dispelled by an authoritative decision of this Court. See concurring opinion of Judge Denison in *Commissioner* v. *Winkler & Bro. Co.*, 53 F. (2d) 580, 583, calling attention to the doubt and conflict on this score, and the differences in the different circuits. See also the divided opinions in recent cases in the First Circuit: *Sturtevant Co.* v. *Commissioner*, 75 F. (2d) 316; *Heywood Boot & Shoe Company* v. *Commissioner*, decided April 1, 1935, not yet reported.

5. **The decision below is utterly inconsistent with the decision of this Court in Helvering, Commissioner, v. Rankin, decided April 29, 1935, not yet reported but see Index 828, United States Law Week.**

In the above case this Court said:

"It was only by departing from the facts as found by the Board that the Court found justification for reversing the Board's decision." The Board found that the stock was distributed by the corporation, that it became the property of the scotkholders, that "the stockholders" made the sale. It likewise found that "at no time did petitioner agree * * * verbally or in writing, to make sale." The court below assumes, without basis in the findings of the Board, that some agency existed, that the sale was made by the petitioner corporation. The decision in *Helvering, Commissioner*, v. *Rankin*, also clearly established that the court below was without authority to consider the new question not presented to the Board below and not raised

in the petition for review before the court. It was injected into the case only upon argument.

WHEREFORE, your petitioner prays that a Writ of Certiorari be issued out of and under the seal of this Honorable Court directed to the United States Circuit Court of Appeals, Fourth Circuit, commanding the court to certify and transmit to this Court for review and determination on a date to be therein named, a full and complete transcript of the record and of the proceedings in the case numbered and entitled on its docket No. 3720, Guy T. Helvering, Comr. of Internal Revenue, Petitioner, *v.* General Utilities and Operating Company, Respondent; and that said judgment of said Circuit Court be reversed by this Honorable Court and that your petitioner have such other and further relief in the premises as to this Honorable Court may seem meet and just, and your petitioner will ever pray.

R. KEMP SLAUGHTER,
HUGH C. BICKFORD,
JOSEPH A. SLATTERY,
Counsel for Petitioner.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

Opinions Below.

The opinion of the U. S. Board of Tax Appeals reported in 29 B. T. A. No. 165, appears at pages 23 to 32 of the printed record. The opinion of the Circuit Court of Appeals, Fourth Circuit, reported in 74 F. (2d) 972, reversing the decision of the U. S. Board of Tax Appeals, was entered January 8, 1935, and appears in the printed record at pages 62 to 72. The judgment of the court entered January 9, 1935, appears at page 73 of the record. Petition for rehearing filed by respondent below on motion approved by the court on February 6, 1935, appears at pages 75 to 131 of the printed record. The petition for rehearing was denied April 2, 1935 (R. 133).

Jurisdiction.

The jurisdiction of this Court is invoked under Section 240 of the Judicial Code as amended by the Act of February 13, 1925, and under Section 1003 of the Revenue Act of 1926.

Facts.

Stripped of useless verbiage the facts are simply that petitioner, through its president, found a purchaser for 20,000 shares of Islands Edison stock which it owned and had acquired at a cost of $2,000. To avoid a double tax on both the corporation and its stockholders on the sale of this stock, petitioner, by resolution of its directors, gave the stock a determined fair market value and declared a dividend payable to its stockholders in stock of the

Islands Edison Company. The stockholders were taxed on the receipt of the dividend, under Article 627 of Treasury Regulations 74, at the fair market value of the stock as indicated by the appreciation entry on the books of the petitioner and its dividend resolution.

The Commissioner, in auditing the tax returns of petitioner, took the position that petitioner in setting up a value of $1,071,426.25 on this stock made a taxable profit of $1,069,517.25 by declaring a dividend payable in stock of the declared value "for the reason that the satisfaction of the obligation by the distribution of the stock was in effect a sale of the stock and a distribution of the proceeds" (R. 8). The Commissioner admitted, however, that if the dividend resolution of petitioner had "merely provided for the distribution of the stock as a dividend there would clearly have been no gain to the corporation" (R. 8).

This was the only question presented to The Board of Tax Appeals, which held adversely to the Commissioner, and appeal was taken to the Circuit Court of Appeals, Fourth Circuit, by the Commissioner. The court, while sustaining the Board in holding that the dividend distribution was made in stock of the Islands Edison Company, decided that "the object was to evade the payment of a tax justly due the Government" and that "in substance the transaction here involved was a sale of the stock of the Islands Edison Company by respondent" (below) (R. 72), on the assumption that the stockholders were the agents of respondent. There was no assignment of error before the court on such a question (R. 50). It was raised for first time in the brief of petitioner below.

The Law.

The applicable provisions of the statutes and regulations are set out in the appendix.

Specifications of Error.

Petitioner makes the following assignments of error which will furnish the basis of the following argument in support of the allowance of writ.

1. The U. S. Circuit Court of Appeals erred in reversing the U. S. Board of Tax Appeals in holding that petitioner derived taxable profit from the sale of certain common capital stock of the Islands Edison Company by its thirty-three stockholders who had received the said stock through a dividend distribution duly authorized and made by the petitioner.

This assignment or error involves the following questions of fact and law:

A. The reality of the transaction.

B. The legal entity of stockholders as distinguished from that of the corporation.

C. The legal effect of a corporate act in the avoidance of taxation.

D. The relationship of the stockholders to the corporation under the principles of agency.

2. The Circuit Court of Appeals erred in rendering opinion on an issue and upon facts not found by the Board but for the first time presented on appellate brief of petitioner below.

ARGUMENT.

The confusion of thought which has arisen in this case begins with the theory of the Commissioner that *a mere declaration and recording of fair market value* of stock owned by a corporation creates taxable gain to a corporation if the stock on this declared value is, by dividend reso-

lution, distributed to stockholders. The Commissioner under this theory overlooks the provisions of his own Regulations (Article 627 of Treasury Regulations 74) which provides for tax to the stockholders at fair market value of the property distributed by dividend regardless of cost. This regulation protects the Treasury if the corporation elects to distribute the property instead of making sale.

The U. S. Board of Tax Appeals has very definitely, however, drawn the distinction between a dividend *payable in cash* and satisfied by payment in property at a value in excess of cost (*Callahan Road Improvement Co.*, 12 B. T. A. 1109; *Bacon-MacMillan Veneer Co.*, 20 B. T. A. 556), and a dividend *payable in property* having a definite fair market value, *First Utah Savings Bank* v. *Commissioner*, 17 B. T. A. 804, affirmed 53 F. (2) 919; Hollenberg Music Co., 6 B. T. A. 421.

We are not concerned here with dividends payable in cash and satisfied by payment in property at a value in excess of cost but as a practical matter it seems that any obligation created voluntarily by a corporation without any benefit to it by way of increment of surplus but in reality an impairment of surplus through dividend distribution does not give rise to "gain derived from capital, from labor, or from both combined, including profit gained through the sale or conversion of capital." *Eisner* v. *Macomber*, 252 U. S. 189; *First Utah Savings Bank*, 53 F. (2d) 919 (C. A. D. C.)

Appreciation has never been recognized by the Commissioner of Internal Revenue as the basis for determining taxable gain. Articles 71 and 322 of Treasury Regulations 74.

(a) *The Reality of the Transaction.*

The Commissioner of Internal Revenue, in his assessment letter from which this appeal was taken under the

provisions of Section 274 of the Revenue Act of 1926 said that if the dividend resolution had

> "merely provided for the distribution of the stock as a dividend there would clearly have been no gain to the corporation" (R. 8).

The Board of Tax Appeals, on the stipulated facts submitted on appeal (R. 11) held (R. 45) that

> "The intent of the directors of petitioner was to declare a dividend payable in Islands Edison stock; their intent was expressed in that way in the resolution formally adopted; and the dividend was paid in the way intended and declared. We so construe the transaction and on authority of First Utah Savings Bank, *supra*, (17 B. T. A. 804, affirmed 53 F. (2) 919), we hold that the declaration and payment of the dividend resulted in no taxable income."

The Circuit Court of Appeals, sustaining these facts found by the Board, said:

> "As to the first contention we are of the opinion that the action of the Board of Tax Appeals was correct. The resolutions of the Board of Directors of the respondent declaring the dividend, is capable of only one interpretation, that the dividend was payable not in cash but in the common stock of the Islands Edison Company. Under this resolution the stockholders could not, in the event of the failure to deliver the stock of the Islands Edison Company, have the right to recover an equal amount of stock. In the case of *The State of Maryland* v. *Baltimore & Ohio Railroad Co.*, 6 Gill 363, a discussion will be found as to a dividend declared under a resolution analagous to the one here in question and in that case a conclusion was reached similar to that reached by us here."

The facts in this case, under judicial opinion, are, therefore, not unreal, as in *Gregory* v. *Helvering*, L. Ed. Adv. Opinions, Vol. 79. The dividend distribution was in corpo-

rate order. There was a vested property in the recipients of the dividend on which taxes were assessable to the recipients at the date of investment at the fair market value of the property (Article 627 of Treasury Regulations 74, applicable to the Revenue Act of 1928).

(b) *The Legal Entity of Stockholders as Distinguished from that of the Corporation.*

The petitioner recording the fair market value of $56.12½ per share for the Islands Edison Company stock declared and paid a dividend payable in that stock. This Court said in *Eisner* v. *Macomber*, 252 U. S. 189:

> "We must treat the corporation as a substantial entity separate from the stockholder, not only because such is the practicable fact but because it is only by recognizing such separateness that any dividend—even one paid in money or property—can be regarded as income of the stockholder."

The dividend was taxable to the stockholders of the petitioner at its designated fair market value of $56.12½ per share. Thereafter the corporation had no title or interest in the property distributed.

(c) *The Legal Effect of a Corporate Act in the Avoidance of Taxation.*

The petitioner exercised a right recognized by the Revenue Acts and the Treasury Regulations applicable thereto. Instead of selling the Islands Edison stock and paying a corporate income tax thereon the stock was, through authorized dividend resolution, distributed to its stockholders and immediately became taxable to the stockholders at its designated fair market value of $56.12½. Article 627 of Regulation 74, *supra*, is the check provided by the Reve-

nue Act and Treasury Regulations to insure collection of internal revenue if a corporation elects to make dividend distribution of property instead of selling property and paying tax on the realized income. The basis of tax in the one instance is the selling price less cost; the basis in the other instance is fair market value regardless of cost. The amount of the tax to the 33 stockholders was impressive in the instant case because the fair market value of the dividend was $1,071,426.25 reaching far into the surtax brackets of some of the stockholders (R. 18, 80).

The court below, acting on argument in appellate brief of petitioner below, and for the first time suggested in the development of the case, said:

> "When we come to consider the sale of the stock of the Islands Edison Company we cannot escape the conclusion that the transaction was deliberately planned and carried out for the sole purpose of escaping taxation. • • • Such admitted facts plainly constituted a plan, not to use the harsher terms of scheme, artifice or conspiracy, to evade the payment of the tax. For the purposes of this decision it is not necessary to consider whether such a course as is here shown constituted a fraud, it is sufficient if we conclude that the object was to evade the payment of a tax justly due the Government."

The answer to this conclusion is found in this Court's opinion in *Gregory* v. *Helvering, supra*, entered one day prior to the decision of the court below.

> "The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes or altogether avoid them by means which the law permits cannot be doubted." *U. S.* v. *Isham*, 17 Wall. 496, 506. *Jones* v. *Helvering*, 71 F. (2d) 214, 217, cert. denied and cited with approval by this Court in the *Gregory* case.

(d) *The Relationship of the Stockholders to the Corporation Under the Principles of Agency.*

The court below further held that

> "The sale of the stock in question was, in substance, made by the respondent company through the stockholders as agents or conduits through whom the transfer of title was effected, * * * In substance the transaction here involved was a sale of the stock of the Islands Edison Company by the respondent."

Agency is a question of fact (*Sloat-Darragh Co.* v. *Gen. Coal Co.*, 276 F. 502 (C. C. A.), *Denton* v. *Bracksmith*, 299 F. 599 (C. C. A. 5)). The stipulated facts do not contain a fact which could establish an agency, but are inconsistent with it. No issue was ever raised in these proceedings that petitioner *sold* the stock of Islands Edison Company until *argument* was made in brief of petitioner in the court below. The issue before the trial court was concise and definite. It had solely to do with a dividend distribution. The stipulated facts are that "no contract of sale was entered into" by the officers of the interested companies; that "a written agreement embodying the terms and conditions of the sale" would be submitted "for *approval* to the *stockholders* of the Islands Edison Company *after* the distribution of said stock by the petitioner." "Lucas never held power of attorney to sell the stock for the petitioner or its stockholders." "At no time did petitioner agree with Whetstone or with the Southern Cities Utilities Company, verbally or in writing, to make sale to him or to the Southern Cities Utilities Company of any of said stock except 910 shares of the Islands Edison Company" (R. 38, 40).

A corporation is not affected by contracts made directly by its stockholders with third persons, whether they own much or little of its stock. *Sellers* v. *Grier, supra; Harris* v. *Muskingam Mfg. Co., supra; Fitzpatrick* v. *O'Neill, supra.*

A sale is defined in the Uniform Sales Act in force in Maryland as follows:

> "A sale of goods is an agreement whereby the seller transfers the property in goods to the buyer for a consideration called the price." (Bagby's Code of Maryland, Art. 83, Sec. 22, subdivision 2).

It is stipulated: "The petitioner received no cash or other property for the distribution of the 19,090 shares of the Islands Edison Company stock." (R. 41).

Agency depends on the consent of the parties, manifested by their affirmative acts.

> "Agency is the relationship which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and his consent by the other so to act.";
>
> "(a) The relationship of agency is created as a result of conduct by the parties manifesting that one of them is willing for the other to act for him subject to his control, and that the other consents so to act. The principal must in some manner indicate that the agent is to act for him and the agent must act or agree to act on his behalf and subject to his control." See Section 1 of the Restatement of the Law of Agency.

The court below, in conflict, said that the negotiations *prior* to the making of the dividend took place "without the stockholders or any of them, who were ostensibly making the sale, being informed, advised or consulted." *After* the distribution, every one of the stockholders acted solely for himself and executed and signed the contract of sale and personally assigned their separate certificates of stock.

2. ***The court below was in error in rendering opinion on facts not found by the Board but for the first time presented on appellate brief of petitioner below.***

The dividend distribution was made March 22, 1928; the stockholders, in their vested right, entered into the contract

of sale of the Islands Edison stock on March 26, 1928. The actual sale took place on May 14, 1928 (R. 41). The selling price differed from the designated market value of the stock at which it was taxable on receipt by the stockholder (R. 40, 41). These facts and those recited under the preceding caption (d) are findings of fact by the Board, and they were binding on the court.

Anchor Co. v. *Commissioner,* 42 F. (2d) 99, 100 (C. C. A. 4);

Merchants Transfer & Storage Co. v. *Burnett,* 49 F. (2d) 56, 58 (C. C. A. 4);

Underwood v. *Commissioner,* 56 F. (2d) 67, 71 (C. C. A. 4);

Old Portland Cement Co. v. *Helvering,* 293 U. S. —, 79 L. Ed. Adv. 170, 173.

The finding of fact by the court below that

> "The sale of the stock in question was, in substance, made by the respondent company, through its stockholders as agents or conduits through whom the transfer of title was effected,"

is not a fact found by the Board but is contrary to the facts found. Agency is a matter of fact. Furthermore, sale of the stock by the corporation as principal or by the stockholders as agents for the principal is nowhere indicated or suggested or submitted in the stipulation of evidence or in the facts found by the Board. Finally, there was no assignment of error before the court which raised the question (R. 50) and the petition for review to the court expressly declared that the "only question to be decided is whether the petitioner realized taxable income in declaring a dividend and paying it in stock of another company" (R. 47). The court erred in departing from the evidence on

an issue raised for the first time in brief of counsel for appellant in the Circuit Court of Appeals.

Phillips v. *Commissioner*, 283 U. S. 589;

Burnet v. *Commonwealth Improvement Co.*, 287 U. S. 415;

Tulsa Tribune Co. v. *Commissioner*, (C. C. A. 10) 58 F. (2d) 937.

CONCLUSION.

On the issue raised and on the facts found in evidence in the trial of the case, the Board of Tax Appeals was correct in finding that the declaration and payment of the dividend in stock of the Islands Edison Company resulted in no taxable income to the petitioner. The Circuit Court of Appeals should be reversed. It is accordingly submitted that the petition for certiorari should be granted.

Respectfully submitted,

R. KEMP SLAUGHTER,
HUGH C. BICKFORD,
JOSEPH A. SLATTERY,
Counsel for Petitioner.

APPENDIX.

Revenue Act of 1928:

SEC. 111. (a) *Computation of gain or loss.*—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.

SEC. 112. (a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

SEC. 113. (a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property.

SEC. 115. (a) *Definition of dividend.*—The term "dividend" when used in this title (except in section 203(a) (4) and section 208 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913.

(b) *Source of distributions.*—For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the basis of the stock provided in section 113.

(c) *Distributions in liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be

treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112.

T. R. 74:

ART. 627. *Dividends paid in property.*—Dividends paid in securities or other property (other than its own stock) in which the earnings of a corporation have been invested, are income to the recipients to the amount of the market value of such property when receivable by the shareholders. (See, however, section 112 (h) and article 576.) Where a corporation declares a dividend payable in stock of another corporation, setting aside the stock to be so distributed and notifying the shareholders of its action, the income arising to the recipients of such stock is its market value at the time the dividend becomes payable. (See article 333.) Scrip dividends are subject to tax in the year in which the warrants are issued.

ART. 71. *Gross income of corporation in liquidation.*— • • • No gain or loss is realized by a corporation from the mere distribution of its assets in kind in partial or complete liquidation, however they may have appreciated or depreciated in value since their acquisition.

ART. 322. *Bases of computation.*— • • • On the other hand, appreciation in value of property is not even an accrual of income to a taxpayer prior to the realization of such appreciation through sale or conversion of the property.

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1935

No. 41

GENERAL UTILITIES & OPERATING COMPANY
Petitioner,

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE
Respondent.

BRIEF FOR PETITIONER.

R. KEMP SLAUGHTER,
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Respondent.

BRIEF FOR PETITIONER.

On June 3, 1935, this Court granted petition for writ of certiorari to the United States Circuit Court of Appeals, Fourth Circuit.

It is not here intended to repeat the argument set forth in the brief supporting the petition for writ of certiorari, but to consider two recent Circuit Court decisions which have direct reference to the opinion of the Fourth Circuit in this appeal.

In this case, the Circuit Court of Appeals below (*Helvering* v. *General Utilities & Operating Company*, 74 Fed. (2) 972,) sustained the United States Board of Tax Appeals in its holding that a dividend had been declared by the General Utilities & Operating Company, payable in

common stock of the Islands Edison Company (29 B. T. A. 165).

In *Commissioner of Internal Revenue* v. *Columbia Pacific Shipping Company*, 77 Fed. (2) 759, decided May 20, 1935, the Circuit Court of Appeals for the Ninth Circuit also held that where a specific sum was set aside from the surplus earnings and appropriated for dividend distribution, that part of the distribution payable and paid in shares of stock owned by the corporation did not result in realized gain taxable as income to the corporation. The decision cited with approval the Board's opinion in this appeal (29 B. T. A. 934) which it says "was affirmed by the Circuit Court of Appeals for the Fourth Circuit January 8, 1935."

The honorable court below thus recognized a dividend distribution of property to the stockholders of the petitioner. *Eisner* v. *Macomber*, 252 U. S. 189. This was in conformity with the action of the Commissioner who, similarly in recognition of the vested right, title and ownership of the stockholders, had assessed and collected taxes from the stockholders on basis of the designated fair market value of the stock so received by them. (Article 627 of Treasury Regulations 74.) The Commissioner cannot now contend and the court below should not have held, on *argument* in appellate brief of counsel for the Commissioner, that the subsequent sale of the stock of Islands Edison Company by its owners (the stockholders) was a sale by the petitioner. No such issue was before the Board. *Helvering* v. *Rankin*, decided by this Court April 29, 1935.

However, the court did hold that the sale of this property, the stock of the Islands Edison Company, by the thirty-three stockholders of the petitioner, was a transaction "deliberately planned and carried out for the sole purpose of escaping taxation" and that "the sale of the stock in question was in substance made by the respondent

company through the stockholders as agents or conduits through whom the transfer of title was effected." (R. 71.)

In *George H. Chisholm* v. *Commissioner*, decided July 8, 1935, by the U. S. Circuit Court of Appeals, Second Circuit, the court said, with respect to this part of the decision of the Fourth Circuit in this appeal:

> "The result, as we view it, should have depended upon whether when the shareholders got the shares in distribution which had been contracted for sale, they were under legal liability to complete the bargain. The opinion declares they were. If not, they were free to choose whether or not to perform the company's contract; the company had not sold. So far as the decision may be thought to go further than this, we cannot agree."

The facts of record stipulated in the trial of the case are that "no contract of sale was entered into" by the officers of the corporation (R. 13, par. 3); that Lucas, the President of the Company, did not hold power of attorney to sell the stock for the petitioner or its stockholders (R. 22, par. 4); that at no time did the petitioner agree with Whetstone, President of the Southern Cities Utilities Company, or with the Southern Cities Utilities Company, "verbally or in writing, to make a sale to him or to the Southern Cities Utilities Company of any of the said stock except 910 shares of Islands Edison Company" (R. 19, par. 7); that "*if a sale* of the 20,000 shares of the common stock of the Islands Edison Company then owned by the General Utilities and Operating Company *was consummated*, such a sale would be made *only after* the General Utilities and Operating Company had distributed the Islands Edison Company shares to its stockholders." (R. 13, par. 3); that "counsel would prepare a written agreement embodying the terms and conditions of the said sale, said agreement to be submitted for *approval of the stock-*

holders of the Islands Edison Company *after* the distribution of said stock by the General Utilities & Operating Company" (R. 11, par. 3); that "the petitioner received no cash or other property for the distribution of said 19,090 shares of the Islands Edison Company common stock." (R. 20, par. 11.) Thus the question of agency was clearly stipulated out of the record.

Notwithstanding these facts of record and the court's own statement that the negotiations prior to the making of the dividend took place "without the stockholders or any of them who were ostensibly making the sale being informed, advised or consulted," the court nevertheless held that "the sale of the stock in question was in substance made by the respondent company through the stockholders as agents or conduits through whom the transfer of title was effected" (R. 71).

The sale contract dated March 26, 1938, executed by each of the stockholders in his own legal right, is a part of the record. (Exhibit E of Stipulation—original photostat, not printed.) (R. 19, par. 7.)

The Commissioner of Internal Revenue, in his assessment letter from which this appeal was taken under the provision of Section 274 of the Revenue Act of 1926, said that if the dividend resolution of the petitioner had "merely provided for the distribution of the stock as a dividend there would clearly have been no gain to the corporation."

The sole question, therefore, before the trial Board was whether the petitioner had made a taxable gain through a dividend distribution payable in stock of the Islands Edison Company which it had appreciated on its books at what the petitioner considered to be its fair market value. (Petition for Review in Fourth Circuit, R. 41.)

Helvering v. *Columbia Pacific Shipping Co., supra.*
First Utah Savings Bank v. *Commissioner,* 17 B. T. A. 804, affirmed 53 Fed. (2) 421.

This is not a case where the evidence is ambiguous or where the transaction is unreal.

Gregory v. *Helvering*, — U. S. —, 79 L. Ed. 295.

The stockholders in their vested right had the free exercise of their discretion in the approval of the contract of sale drawn by counsel, because it was so stipulated. There is no fact in the evidence to suggest that the stockholders "were under legal liability to complete the bargain." As "they were free to choose whether or not to perform the company's contract, the company had not sold."

Chisholm v. *Commissioner*, *supra*.

Conclusion.

It is respectfully submitted that the decision of the United States Circuit Court of Appeals, Fourth Circuit, is erroneous and should be reversed and that the decision of the United States Board of Tax Appeals that

> "the intent of the directors of the petitioner was to declare a dividend payable in Islands Edison stock; their intent was expressed in that way in the resolution formally adopted; and the dividend was paid in the way intended and declared. We so construe the transaction and on authority of First Utah Savings Bank, *supra*, we hold that the declaration and payment of the dividend resulted in no taxable income"

should be sustained.

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1935

No. 41

GENERAL UTILITIES AND OPERATING COMPANY,
Petitioner,

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE.

REPLY BRIEF FOR PETITIONER.

R. KEMP SLAUGHTER,
HUGH C. BICKFORD,
JOSEPH A. SLATTERY,
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GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE.

REPLY BRIEF FOR PETITIONER.

In reply to the brief of respondent we wish simply to call attention to several omissions therefrom and to place in the record some authorities made necessary by such brief. The omissions from respondent's brief are, in the main, two in number.

1. *The respondent fails to connect his argument with the facts as stipulated in this case.*

The respondent argues generally a number of propositions of law concerning the nature of income under different circumstances and sets forth his viewpoint that an appreciation of value should be taxed because such appreciation is an economic increment. At least, so we understand his argument. At no place in this argument does the respond-

ent quote the portions of the stipulated facts upon which he relies. In fact, he carefully avoids such stipulated facts. He argues (p. 13-14) that petitioner corporation made a "sale or other disposition" but ignores the stipulated fact that "at no time did" petitioner "agree • • • verbally or in writing • • • to make sale." (R. 16.) He argues that petitioner "transferred" its stock (p. 15) without stating that it is stipulated that the "transfer" was simply by dividend distribution and that "petitioner received no cash or other property for the distribution." He argues that if the corporation is not taxed on the appeciation in value such appreciation "will never be subject to tax," and ignores the fact that the entire appreciation *was* taxed to the stockholders who received it. In the final phases of his argument, he contends (p. 34-37) that the stockholders were the agents of the corporation but does not cite any portion of the stipulation which establishes a contract, appointment, or acceptance of agency. He ignores the stipulated facts which establish that the stockholders received full title to the stock and acted for themselves in selling. (R. 15-16.)

In short, counsel argues general principles of law without connecting them with the stipulation of facts in this case. For example, on pages 35 and 36 he cites a number of cases in which agency was held to exist although some single element was lacking in each case. He has not (and we believe, cannot) cite a case in which it was held that an agency existed where no element of agency was established as a fact.

2. *The brief of the respondent does not refer to the provision of the revenue act expressly answering the argument which he makes.*

The respondent, at great length, argues that appreciation in value is an economic benefit which should be taxed;

that when the appreciation no longer could be extended, because the stock was distributed, there was an economic gain. He founds this upon Section 111 (a) of the Revenue Act which provides that the gain shall be the excess of the "amount realized" over the cost or other base and submits economic doctrine and legal theory to show what is the meaning of the phrase "amount realized." He does not mention the fact that the phrase "amount realized", which alone may be taxable gain, is expressly defined by subdivision (c) of section 111 as follows:

> "The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received."

There is therefore no necessity for substituting economic theory or legal doctrine for the express definition of the statute as to what is meant by the amount realized. The statute says that it shall only be the "money received" or the money equivalent in other property received. The stipulation of fact here answers this definition. It is stipulated, plainly, that the petitioner "received no cash or other property for the distribution of said 19,090 shares of the Islands Edison Company common stock." (R. 18.) If the statute taxes only the money received and it is stipulated that none was received it would seem clear that no income taxable by the statute was present.

As to respondent's general argument of economic doctrine, it should be sufficient to quote Mr. Justice Holmes' expression in *Weiss* v. *Weiner*, 279 U. S. 334:

> "The income tax laws do not profess to embody perfect economic theory. They ignore some things that either a theorist or a business man would take into account in determining the pecuniary condition of the taxpayer. They do not charge for appreciation of property or allow a loss from a fall in market value

unless realized in money received by a sale. *United States* v. *S. S. White Dental Co.*, 274 U. S. 398, 401. A stockholder does not pay for accumulated profits of his corporation unless he receives a dividend. That is the general principle upon which these laws go."

Finally, the whole effect of respondent's argument is to ignore entirely the corporate entity and to treat petitioner as identical with its widely scattered 33 stockholders. As no unusual or peculiar circumstances are present in the case, such reasoning is contrary to the consistent expressions of this Court since the enactment of the 16th Amendment. *Lynch* v. *Hornby*, 247 U. S. 339; *Eisner* v. *Macomber*, 252 U. S. 189; *U. S.* v. *Phellis*, 257 U. S. 156; *Rockefeller* v. *U. S.*, 257 U. S. 176; *Burnet* v. *Commonwealth Improvement Co.*, 287 U. S. 415; *Burnet* v. *Clark*, 287 U. S. 410; *Dalton* v. *Bowers*, 287 U. S. 404; *Jones* v. *Helvering*, 71 F. (2) 214 (App. D. C.).

Respectfully submitted,

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(7105-C)

FILE COPY

No. [redacted] 41

In the Supreme Court of the United States

OCTOBER TERM, 1934

GENERAL UTILITIES AND OPERATING COMPANY,
PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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In the Supreme Court of the United States

OCTOBER TERM, 1934

No. 939

GENERAL UTILITIES AND OPERATING COMPANY, petitioner

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 36–45) is reported in 29 B. T. A. 934. The opinion of the Circuit Court of Appeals (R. 62–72) is reported in 74 F. (2d) 972.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered January 9, 1935 (R. 73). A petition for rehearing was filed February 6, 1935 (R. 75), and was denied April 2, 1935 (R. 134). Petition—

for a writ of certiorari was filed May 3, 1935. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the petitioner derived taxable profit on the sale of certain stock which it owned at the time the purchase price and general terms of the sale were agreed upon by the purchaser and the petitioner's president but which it distributed to its stockholders by way of dividend before the sale was consummated.

STATUTES INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791:

> SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.
>
> (a) *Computation of gain or loss.*—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.
>
> * * * * *
>
> (e) *Amount realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.
>
> * * * * *

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; * * *

* * * * * * *

STATEMENT

The following material facts are taken from the findings of the Board of Tax Appeals (R. 37–42), which were based upon a stipulation of the parties (R. 11–23):

The petitioner is a Delaware corporation, with its principal offices at Baltimore, Maryland. It is engaged in the business of owning securities of, managing, and operating public utility properties. On January 1, 1927, it acquired 20,000 shares of the common capital stock of another corporation, the Islands Edison Company, at a cost of $2,000. The said shares constituted one-half of the outstanding common stock of the Islands Edison Company, the remaining 20,000 shares being owned by Gillet & Company, which is not connected with the petitioner or its stockholders (R. 37).

During the month of January 1928 Walter Whetstone, president of the Southern Cities Utilities Company, became interested in acquiring control of a Santo Domingo company, the stock of which was owned by the Islands Edison Company. During a conference with J. C. M. Lucas, president of peti-

tioner, Whetstone discussed the purchase of the Santo Domingo Company or the Islands Edison Company common stock and as a result thereof was given permission to make an investigation of the properties of the Santo Domingo Company. Sometime in February of 1928 Whetstone informed Gillet and Lucas that his plans required the delivery of all the common stock of the Islands Edison Company, that he was informed by Gillet that his firm was ready and willing to make the sale of the 20,000 shares owned by Gillet & Company of the Islands Edison Company common stock, and that he (Gillet) and Lucas, president of petitioner, had agreed upon the price at which the sale would be made. Whetstone was informed by Lucas that if a sale of the 20,000 shares of the common stock of the Islands Edison Company then owned by the petitioner were consummated, such a sale would be made only after petitioner had distributed the Islands Edison Company shares to its stockholders, because they had been advised by their attorneys that if sale were made by petitioner it would be subject to a tax on any profit realized on the sale and that when the proceeds of the sale were distributed to the stockholders, the stockholders would have to pay another tax thereon. The price to be paid for the properties and the terms and conditions of the sale generally were agreed upon by Gillet, Lucas, and Whetstone, but no contract was entered into by them, it being understood and agreed between them that petitioner would make distribution of the

stock of the Islands Edison Company to its stockholders and that counsel would prepare a written agreement embodying the terms and conditions of the sale, the agreement to be submitted for approval to the stockholders of the Islands Edison Company after the distribution of said stock by the petitioner. Lucas never held power of attorney to sell the stock for the petitioner or its stockholders (R. 37–38).

At a meeting of the petitioner's directors on March 22, 1928, it was reported as the opinion of the petitioner's officers that the stock was worth at least $1,122,500. Resolutions were passed authorizing appreciation of petitioner's holdings on its books in the amount of $1,120,500 and declaring a dividend of $1,071,426.25 on the petitioner's common stock payable in stock of the Islands Edison Company at a valuation of $56.125 a share. On the same day the petitioner simultaneously made appropriate entries upon its books of account in compliance with this resolution (R. 38–39).

On March 22, 1928, in accordance with the resolution of the Directors, the petitioner distributed to its own stockholders 19,090 shares of the stock of the Islands Edison Company, such shares representing two shares of the Islands Edison Company stock theretofore owned by petitioner for each one share of the 9,545 shares of petitioner's own capital stock then outstanding. On the same date the shares of stock were transferred on the stock rec-

ords of the Islands Edison Company to the individuals receiving the distribution. After transfer of the 19,090 shares there remained in the hands of petitioner 910 shares of stock of the Islands Edison Company, which 910 shares were retained by it and a new certificate for such shares was issued to it on March 22, 1928 (R. 40).

On March 26, 1928, the stockholders of the Islands Edison Company (one of which was the petitioner, owning 910 shares) and the Southern Cities Utilities Company, entered into a written contract of sale of the Islands Edison Company stock. At no time did petitioner agree with Whetstone or the Southern Cities Utilities Company, verbally or in writing, to make sale to him or to the Southern Cities Utilities Company of any of said stock, except the 910 shares of the Islands Edison Company (R. 40).

The net consideration for the Islands Edison Company stock as computed in the contract of March 26, 1928, was $2,245,000, and this amount, divided by the number of shares (40,000), gives a quotient of $56.125 per share (R. 40–41). The 910 shares retained by the petitioner were sold to the Southern Cities Utilities Company on May 14, 1928, and a profit of $46,346.30 was reported on the petitioner's 1928 return, computed on a sale price of $51.25 per share less a cost of $0.10 per share. The difference between the amount of $56.125 per share, set forth as the price stated in the contract of

March 26, 1928, and the amount of $51.25, shown as the amount received on May 14, 1928, when the sale was made, is represented by brokerage charges, commissions, and other expenses incident to the consummation of the sale which were charged against the stockholders in accordance with the provisions of the contract. The petitioner received no cash or other property for the distribution of the 19,090 shares of the stock (R. 41).

The petitioner in making its income-tax return for the year 1928 reported no income from the disposition of the 19,090 shares of the Islands Edison Company common stock. Upon audit of the return the Commissioner held that petitioner derived a profit of $1,069,517.25 from the disposition thereof, giving as his explanation that this gain was realized upon distribution of the stock measured by the difference between the market value of $56.125 in satisfaction of a dividend obligation and the cost of $0.10 a share (R. 42).

The Board of Tax Appeals held that the declaration and payment of the dividend in stock resulted in no taxable income to the petitioner (R. 44–45). The Circuit Court of Appeals affirmed the Board's decision in this respect but held that the sale was in substance made by petitioner through its stockholders as agents or conduits through whom the transfer of title was effected, and reversed and remanded the case for further proceedings in accordance with its opinion (R. 71–72).

ARGUMENT

We submit that the court below was justified in holding that the petitioner is taxable on the gain represented by the difference between the sale price of the stock to the Southern Cities Utilities Company and its cost to the petitioner. The fact that the theory upon which the decision was based differed from that urged before the Board does not present a conflict requiring review by this Court. It may be conceded that some of the Circuit Courts of Appeals have declined to consider issues which were not raised before the Board of Tax Appeals, and that it is the practice of this Court that it will not consider issues not raised below. *Phillips* v. *Commissioner*, 283 U. S. 589, 605; *Burnett* v. *Commonwealth Imp. Co.*, 287 U. S. 415. But this is a rule of practice rather than a limitation of power. *Story Parchment Co.* v. *Paterson Co.*, 282 U. S. 555. The court below has reversed the Board on questions raised for the first time on appeal and has stated that it will not turn the taxpayer out of court because he may have misconceived his remedy. *Underwood v. Commissioner*, 56 F. (2d) 67 (C. C. A. 4th); *Virginia-Lincoln Furniture Corp.* v. *Commissioner*, 56 F. (2d) 1028, 1033 (C. C. A. 4th). The Government did not seek certiorari in those cases. And see *Seufert Bros. Co.* v. *Lucas*, 44 F. (2d) 528 (C. C. A. 9th).

This is not a case in which a corporation has distributed assets to its stockholders who thereafter find and sell to a purchaser. Here the stipulated

facts upon which the case was heard show that negotiations were commenced by the petitioner's president, and the purchase price and general terms of the sale were agreed upon before the stockholders had any right or title to the stock (R. 12–13, 38). The purchaser's plans required delivery of all the stock and not a part thereof (R. 12, 37). Before distribution all arrangements, short of legally binding contracts, were made, and it was agreed that the petitioner would make distribution of the stock and that counsel would prepare a written agreement embodying the terms and conditions of the sale to be submitted for approval to the Islands Edison Company stockholders after distribution (R. 13, 38). Such contract was prepared and approved and all the stockholders joined in selling the stock (R. 19, 40), thus ratifying the arrangements theretofore made.

Where a plan of action exists the courts will view the whole rather than subdivide into independent steps. *Prairie Oil & Gas Co.* v. *Motter,* 66 F. (2d) 309, 311 (C. C. A. 10th); *West Texas Refining & D. Co.* v. *Commissioner,* 68 F. (2d) 77 (C. C. A. 10th); *Commissioner* v. *Owens,* 69 F. (2d) 597 (C. C. A. 5th). Moreover, in matters of taxation the substance rather than the form of a transaction will be regarded. *United States* v. *Phellis,* 257 U. S. 156; *Phelps* v. *Commissioner,* 54 F. (2d) 289 (C. C. A. 7th). In substance there was one whole plan contemplated from its inception, and although the stockholders of the petitioner each

received title to a portion of the property this was but one step in carrying out a plan which was in essence a sale of the whole block owned by the petitioner through the instrumentality of its stockholders. In somewhat analogous circumstances the courts, viewing the whole transaction, have been guided by the substance rather than the form the transaction was permitted to follow. Cf. *Hellebush* v. *Commissioner,* 65 F. (2d) 902, 904 (C. C. A. 6th); *S. A. MacQueen Co.* v. *Commissioner,* 67 F. (2d) 857, 858 (C. C. A. 3rd).

Conceding the legal right of a taxpayer to avoid what would otherwise be his taxes by means which the law permits, as petitioner urges, nevertheless this principle, we submit, does not prevent the court from viewing a transaction as a whole or from recognizing its realities. The language used in *Gregory* v. *Helvering,* 293 U. S. 465, is pertinent. There this Court said (p. 469) that the proceeding was:

> Simply an operation having no business or corporate purpose—a mere device which put on the form of a corporate reorganization as a disguise for concealing its real character, and the sole object and accomplishment of which was the consummation of a preconceived plan, not to reorganize a business or any part of a business, but to transfer a parcel of corporate shares to the petitioner. No doubt, a new and valid corporation was created. But that corporation was nothing more than a contrivance to the end last

described. It was brought into existence for no other purpose; it performed, as it was intended from the beginning it should perform, no other function.

The decision is not in conflict with that of the United States Court of Appeals of the District of Columbia in *Jones* v. *Helvering,* 71 F. (2d) 214, certiorari denied, 293 U. S. 583, in which the facts and question presented were substantially different. There it was held that sales made for adequate consideration were none the less valid for tax purposes although the sellers owned a controlling stock interest in the purchaser and could have sold at a fictitious price. Nor is there a conflict, we submit, with *Helvering* v. *Rankin,* No. 582, October Term, 1934, decided by this Court April 29, 1935. In that case the court below departed from the facts found by the Board of Tax Appeals and assumed the existence of facts inconsistent with those found, and this Court held that it was not within the province of the court to make such findings. Here all the facts were stipulated, and on such stipulated facts the court determined that in substance there was a sale by the petitioner through the instrumentality of its stockholders.

Petitioner urges (Pet. 8) that the decision assigns a selling price of $56.125, whereas the basis was only $51.25. The actual selling price was $56.125 per share (R. 19). It is not clear from the stipulation (R. 19–20) whether all of the brokerage charges and commissions were absorbed by the

petitioner on its sale direct of 910 shares or whether such charges and commissions amounted to the sum of $4,875 on each of the 20,000 shares sold which had been owned by the petitioner. In any event, the court did not attempt to determine the amount of taxable gain but remanded the case for further proceedings. In such proceedings the amount of taxable gain may be determined.

CONCLUSION

The case depends largely upon its own facts, and upon those facts as stipulated the court below reached the correct result. There is no conflict of decisions requiring a review by this Court. The petition should be denied.

Respectfully submitted,

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In the Supreme Court of the United States

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No. 41

GENERAL UTILITIES AND OPERATING COMPANY, petitioner

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GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 31–39) is reported in 29 B. T. A. 934. The opinion of the Circuit Court of Appeals (R. 50–59) is reported in 74 F. (2d) 972.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered January 9, 1935. (R. 59–60.) A petition for rehearing was filed February 6, 1935 (R.

60), and was denied April 2, 1935 (R. 60–61). The petition for a writ of certiorari was filed May 3, 1935, and granted June 3, 1935 (R. 61–62).. The jurisdiction of this Court is conferred by Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

Petitioner was the owner of 20,000 shares of stock in another corporation which had appreciated in value in petitioner's hands in excess of $1,000,000. Petitioner secured a purchaser for the stock and arranged the details of sale. Thereupon, pursuant to corporate resolution, petitioner distributed all but 910 shares of the stock to its stockholders and at the same time submitted for their approval a written agreement embodying the terms and conditions of sale, which covered all, but not part, of the shares. The agreement was signed by petitioner and all of the stockholders and the consideration was paid to them in proportion to their several interests.

Upon these facts the questions presented are: Whether petitioner realized a taxable gain (1) upon the disposition of the 19,090 shares to its stockholders; or (2) upon the sale of those shares to the purchaser.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra*, pp. 42–43.

STATEMENT

The following facts were stipulated by the parties (R. 9–20), and were included in substance in the Board's findings of fact (R. 32–36):

The petitioner is a Delaware corporation, with its principal offices in Baltimore, Maryland. Petitioner is engaged in the business of owning securities of, managing, and operating public utility properties. (R. 9–10.)

On January 1, 1927, the petitioner corporation acquired 20,000 shares of no par value of the common capital stock, Certificate #C–2, of another corporation, the Islands Edison Company. Said 20,000 shares of stock constituted one-half of the total 40,000 shares of common capital stock of said Islands Edison Company outstanding; the remaining 20,000 shares, Certificate #C–1, were owned by Gillet and Company, Baltimore, Maryland, which company is not connected with petitioner nor with petitioner's stockholders. Petitioner acquired said 20,000 shares of common capital stock of the Islands Edison Company at a cost to it of $2,000 and set up such stock on its books at a total value of $2,000. (R. 10.)

During the month of January, 1928, Walter Whetstone, president of the Southern Cities Utilities Company, became interested in acquiring control of the Compania Electricia de Santo Domingo, the stock of which was owned by the Islands Edison Company. During a conference with J. C. M.

Lucas, president of the petitioner, Mr. Whetstone discussed the purchase of the Santo Domingo Company or the Islands Edison Company common stock and as a result thereof was given permission to make an investigation of the properties of the Santo Domingo Company. Some time in February of 1928, Mr. Whetstone informed Mr. Charles Gillet and Mr. Lucas that his plans required the delivery of all the common stock of the Islands Edison company. He was informed by Charles Gillet that Gillet and Company was ready and willing to make the sale of the 20,000 shares owned by Gillet and Company of the Islands Edison Company common stock, and that he (Gillet) and Mr. Lucas, president of petitioner, had agreed upon the price at which the sale of all the stock of Islands Edison Company would be made. Mr. Whetstone was informed by Mr. Lucas that if a sale of the 20,000 shares of the common stock of the Islands Edison Company then owned by the petitioner was consummated such a sale would be made only after the petitioner had distributed the Islands Edison Company shares to its stockholders, because they had been advised by their attorneys that if sale were made by petitioner it would be subject to a tax on any profit realized on the sale and that when the proceeds of the sale were distributed to the stockholders the stockholders would have to pay another tax thereon. The price to be paid for the properties and generally the terms and conditions of the sale were agreed upon by Messrs. Gillet, Lucas and

Whetstone, but no contract was entered into by them, it being understood and agreed between them that the petitioner would make distribution of the common stock of the Islands Edison Company to its stockholders, and that counsel would prepare a written agreement embodying the terms and conditions of the said sale, said agreement to be submitted for approval to the stockholders of the Islands Edison Company (after the distribution of said stock by the petitioner). (R. 10–11.)

On March 22, 1928, the following transpired at a meeting of the Board of Directors of the petitioner corporation as reflected by the minutes of said meeting (R. 11–13):

* * * * *

> The Chairman called to the attention of the meeting the fact that the Company was carrying on its books 20,000 shares of Common Stock of the Islands Edison Company at a gross valuation of $2,000; he made an extended statement to the Board dealing with the development of and the present condition of the properties of that Company, its record of gross and net earnings and a forecast of the earnings which should be made in the immediate future as a result of extensions of facilities initiated and to a large extent completed; he stated that the officers of the Company after careful analysis of the properties and affairs of the Islands Edison Company, were of the opinion that the Common Stock of that Company which is owned by this Company is worth at

least $1,122,500.00 and should be appreciated on the books of this Company to that amount; he explained that such an appreciation would, of course, involve a credit to surplus account of the Company arising from appreciation of assets and a debit to its asset account in the amount of $1,120,500.00.

The Chairman also suggested to the meeting that the Company consider declaring a dividend on the Common Stock of the Company in the amount of $1,071,426.25, payable out of the appreciation so set up, the dividend to be paid in Common Stock of the Islands Edison Company at a value of $56.12½ a share.

Whereupon the following resolutions were unanimously passed, viz:

(a) that this Company appreciate on its books, its holdings of Common Stock of The Islands Edison Company in the amount of 20,000 shares in the amount of $1,120,500.00 and that the amount of this appreciation be credited to surplus arising from appreciation of assets;

(b) that a dividend in the amount of $1,071,426.25 be and it is hereby declared on the Common Stock of this Company, payable in Common Stock of The Islands Edison Company at a value of $56.12½ a share, out of the surplus of the Company arising from the appreciation in the value of the Common Stock of The Islands Edison Company held by this Company, viz., $1,120,500.00, the payment of the dividend to be made by the delivery to the stockholders

of this Company, pro rata, of certificates for the Common Stock of The Islands Edison Company held by this Company at the rate of two shares of such stock for each share of Common Stock of this Corporation; the stockholders entitled to be those of record at the close of business this day.

* * * * *

The petitioner thereupon, on March 22, 1928, made the entries on its books of account in compliance with the foregoing resolution. (R. 13.)

Thereupon, on March 22, 1928, in accordance with the resolution of the Board of Directors hereinabove set forth, the petitioner distributed to its own stockholders, 19,090 shares of the said common capital stock of the Islands Edison Company, such shares representing two shares of the Islands Edison Company stock theretofore owned by petitioner for each one share of the 9,545 shares of petitioner's own capital stock then outstanding. On such date, March 22, 1928, the said shares of stock were transferred on the stock records of the Islands Edison Company to the individuals receiving the distribution; the certificate, #C–2, theretofore issued to the petitioner was cancelled, and certificates Nos. C–3 to 35 were issued to the thirty-three stockholders of petitioner corporation at that date who received such distribution. (R. 15.)

After transfer of the 19,090 shares as aforesaid, there remained in the hands of petitioner 910 shares of stock of the Islands Edison Company,

which 910 shares were retained by it and a new certificate, #C–36, was issued to it on March 22, 1928. (R. 16.)

On March 26, 1928, the stockholders of the Islands Edison Company (one of which was the petitioner, the owner of 910 shares of Islands Edison Company common stock) and the Southern Cities Utilities Company entered into a contract of sale of The Islands Edison Company common stock. At no time did petitioner agree with the aforesaid Walter Whetstone or the Southern Cities Utilities Company, verbally or in writing, to make sale to him or to the Southern Cities Utilities Company of any of said stock except the aforesaid 910 shares of the Islands Edison Company. (R. 16.)

The fair market value of the Islands Edison Company common stock as of March 22, 1928, was $56.12½ per share. (R. 16.)

The earned surplus from operations as of December 31, 1927, was $1,360,515.96, which amount was not impaired by operating losses prior to March 22, 1928. Such surplus and all the capital of the company at December 31, 1927, were invested at cost in assets of the company, of which assets only $41,152 was cash. On March 22, 1928, the total cash of petitioner was not more than $49,004.23. (R. 17.)

The 910 shares of the Islands Edison Company common stock, Certificate #C–36, which were retained by the petitioner after the said distribution

of 19,090 shares to its stockholders on March 22, 1928, as referred to in paragraph 6 of the stipulation, were sold to the Southern Cities Utilities Company on May 14, 1928, in accordance with the provisions of paragraph 7 of the stipulation, and on which a profit of $46,346.30 was reported on the 1928 return as filed by the petitioner, computed in said return as follows (R. 17):

Sales price of 910 shares at $51.25 per share	$46,437.30
Cost of 910 shares at 10¢ per share	91.00
Profit reported in return	$46,346.30

The difference between the amount of $56.12½ per share, set forth above as the price stated in the contract of March 26, 1928, and the amount of $51.25 as shown in this paragraph as the amount received on May 14, 1928, when sale was made, is represented by brokerage charges, commissions and other expenses incident to the consummation of the sale which were charged against the stockholders in accordance with paragraph Eighth of the contract dated March 26, 1928. (R. 17.)

The petitioner received no cash or other property for the distribution of said 19,090 shares of the Islands Edison Company common stock. (R. 18.)

Petitioner corporation, in making its income tax return for the calendar year 1928, reported no income from the disposition of the 19,090 shares of the Islands Edison common stock. The Commissioner of Internal Revenue, upon auditing said return, held that petitioner corporation derived a profit of $1,069,517.25 from the disposition thereof,

the Commissioner's ruling thereon being in part as follows (R. 18):

> It is therefore held that your corporation realized a taxable gain of $1,069,517.25 upon the distribution of The Islands Edison Company stock in payment of the dividend of $1,071,426.25, as follows:
>
> | | |
> |---|---|
> | Distribution of 19,000 shares of stock at market value of $56.125 a share in satisfaction of dividend obligation | $1,071,426.25 |
> | Cost of stock distributed, $0.10 a share | 1,909.00 |
> | Profit realized | 1,069,517.25 |

The Board of Tax Appeals expunged the deficiency (R. 28–29) on the theory that no taxable gain was realized by the petitioner in the distribution of the stock of the Islands Edison Company to its stockholders (R. 26–28). The Circuit Court of Appeals reversed the Board and sustained the deficiency on the theory that the sale was, in substance, made by the petitioner through the agency of its stockholders. (R. 56–59.)

SUMMARY OF ARGUMENT

Where a corporation invests its funds in property which appreciates in value in its hands, we submit that a distribution of such property to its stockholders is a disposition which may result in gain. There is a closed and completed transaction. The corporation has lost control of the property and is unaffected by subsequent fluctuations in its value. In such circumstances we think that the distribution is such an identifiable event as to

be properly regarded as a disposition. While the petitioner realized no consideration in a tangible form, the increased value was made available to it and petitioner was thus enabled to utilize it for a corporate purpose. For an investment of $1,909 petitioner was able to pay its stockholders the equivalent of $1,071,426.25 in cash, and we submit that petitioner thereby realized the economic benefit which would have followed the actual receipt of the gain in cash. By the distribution petitioner satisfied its general liability to account to its stockholders for the funds invested in the property and its increment.

But if more is necessary, and the form of the dividend declaration is controlling, we submit that petitioner satisfied a specific liability of $1,071,426.25 by the delivery of property costing only $1,909, and that upon well-settled principles petitioner thereupon realized the difference as gain, profit or income within the plain popular meaning of the terms.

In the alternative, and if petitioner failed to realize a gain by using the appreciation to satisfy either a general or a specific liability, then we submit that the sale should be attributed to petitioner. The plan of sale was devised by petitioner. It arranged the terms with the purchaser and prepared the papers. The purchaser desired all, but not a part, of the shares, and since petitioner retained 910 of the shares, it is extremely unlikely that petitioner would have distributed part of the shares if

it would have jeopardized its opportunity to sell the remainder. Petitioner planned a transaction which would insure that its stockholders would get cash, and the only part which the stockholders took in the transaction was to consummate the agreement which petitioner prepared. Under the circumstances, we submit that the distribution to the stockholders was but a step in the sale and that, considering the transaction as a whole, the sale was made by the petitioner through the medium of its stockholders. When they accepted petitioner's plan the stockholders became parties to it and served merely as conduits for conveying petitioner's title to the purchaser. The line between a corporation and its stockholders is not so well marked and so clearly defined that a plan of sale, conceived on the corporate side and there carried to a point just short of consummation, must be deemed to have wholly occurred on the stockholders' side merely because care is taken to complete it there. We think the substance of the transaction was a sale by petitioner and a cash distribution to its stockholders.

Petitioner's contention that the Circuit Court of Appeals was without authority to consider the question whether petitioner made a profit on the sale is predicated on the view that appellate courts lack the power to entertain a different theory from that upon which the case was decided below. We submit that the question thereby raised is one of practice only, and does not involve a limitation of

judicial power. Since the court below entertained the theory, it is settled that this Court will consider it.

ARGUMENT

I

WHERE A CORPORATION PAYS A DIVIDEND IN SECURITIES WHICH HAVE ENHANCED IN VALUE, IT THEREBY REALIZES THE GAIN ON ITS INVESTMENT

Section 22 of the Revenue Act of 1928 (*infra*, p. 42) defines gross income. It includes "gains * * * from * * * sales, or dealings in property * * *." Section 111 (a) (*infra*, p. 42) provides "the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113 * * *." Section 113 *infra*, p. 43) provides, so far as pertinent here, that the basis for determining gain from the "sale or other disposition" of property shall be the cost of such property.

The cost of the property here involved has been stipulated; also the selling price. Accordingly, the problem is simply whether petitioner made a "sale or other disposition". The basis upon which the deficiency was asserted was that petitioner had realized on its property a profit by using it to satisfy a dividend liability of $1,071,426.25. (R. 7.) This theory of the case was rejected by both the Board of Tax Appeals and the Circuit Court of

Appeals because they found no specific liability to pay a dividend in cash. We think that under the facts there was a specific liability. We submit, however, that such a liability is not requisite, because the payment of a dividend discharges a general liability to distribute profits and is a "disposition" which may give rise to gain or loss.

The term "sale or other disposition" embraces all closed and completed transactions. It does not include mere fluctuations in value. *United States* v. *White Dental Co.*, 274 U. S. 398. That case involved the right to a deduction for a loss, and this Court interpreted the statute and regulations as follows (p. 401):

> But with equal certainty they do contemplate the deduction from gross income of losses, which are fixed by identifiable events, such as the sale of property (Art. 141, 144), or caused by its destruction or physical injury (Art. 141, 142, 143) or, in the case of debts, by the occurrence of such events as prevent their collection (Art. 151).

It was held that sequestration of property by the German Government was an event justifying the deduction without the taxpayer's establishing that there was no possibility of eventual recoupment. The rationale of that decision is that any event which terminates the taxpayer's control over the property and prevents future fluctuations from affecting him may properly be regarded as a disposition.

A similar application of the statute was made in *DeLoss* v. *Commissioner,* 28 F. (2d) 803 (C. C. A. 2d). There the taxpayer held stock which became worthless in 1920. He sold a portion in 1920 and the balance in 1921, and claimed a deduction in each year, relying upon the literal language of the statute as always permitting losses upon sales. But the Circuit Court of Appeals held that a sale under such circumstances was necessarily fictitious and established nothing, for when a security can no longer fluctuate in value, there is no variable to determine, and to extend the usual doctrine to the extent contended for would serve only to allow a taxpayer to manipulate his loss. Accordingly, it was held that the loss upon the shares sold in 1921 was sustained in 1920.

Those cases deal with losses, but we submit that they are equally applicable to gains, since gains and losses are correlative and are governed by the same concepts. Here the petitioner disposed of its property by a transfer which made it impossible for future fluctuations in value to affect petitioner. Whether the stock increased in value thereafter or whether subsequently it became worthless, had no further economic effect upon petitioner. Petitioner invested its funds in the stock and the appreciation in its value up to the time of the transfer was the full measure of the economic result of the investment. We submit that the transfer was an identifiable event which clearly falls within the term "sale or other disposition." The trans-

action was closed and the transfer served as an occasion for determining gain.

It is true that the Court of Appeals for the District of Columbia reached a contrary conclusion in *First Sav. Bank of Ogden* v. *Burnet*, 53 F. (2d) 919, although it recognized that (p. 920) "This question is not free from doubt", and conceded (p. 921) that "It is true that the rule hereby adopted leads to an anomalous result." There a corporation invested funds in securities which declined in value, whereupon the corporation distributed them to its stockholders as a dividend and claimed as a deduction the difference between cost and the market value on the date when the transfer to the stockholders occurred. Applying the rule of *ejusdem generis* the court construed the phrase "sale or other disposition" to relate only to such dispositions of property as are like sales. Because the stockholders paid no consideration for the securities they received as a dividend, and because no cash dividend was declared which the securities were used to satisfy, the court concluded that the transfer in question was not within the statutory language.[1]

[1] Support for this result was found in the Treasury Regulations dealing with distributions in kind upon dissolution, because in the opinion of the court there was no difference in principle between such distributions in dissolution and similar distributions not in dissolution. This reasoning ignores the distinction between ordinary and liquidating dividends made by the Regulations themselves and recognized by this Court in *Hellmich* v. *Hellman*, 276 U. S. 233. The rea-

If losses are not sustained in such transactions, it would follow that no gain is realized unless the dividend is first declared in cash. But it seems to us that the entire situation should be re-examined with a view to ascertaining if there is not a basis whereby both gains and losses should be recognized in such transactions. Where the property declines in value in its hands a corporation which distributes it as a dividend has suffered an economic loss as surely as though it disposed of the property by sale. It has lost control of the property and remains unaffected by further fluctuations. If such an event does not constitute a basis for a loss there will be no later occasion upon which the corporation may predicate its claim.

Similarly, where the property has increased in value in its hands and a corporation distributes it as a dividend, it has derived an economic gain to the same extent as though it had disposed of the property by sale, and if the gain is not taxed at that time, the amount by which the property has appreciated in value will never be subject to tax, for the property takes a new basis in the hands of the stockholders, namely, the value at the time of distribution.

It is not open to doubt that the phrase "sale or other disposition" connotes a transfer by which a

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son why no gain is recognized upon even a partial liquidation is that the stock is surrendered and it is a capital transaction, from the standpoint of both the corporation and the stockholders.

gain is realized or a loss is sustained, and one of the principal reasons for rejecting the suggestion that a dividend distribution is a "disposition" has been the circumstance that the stockholders pay no consideration to the corporation, and hence there is no actual receipt of gain in a tangible form.[2] We think that this reasoning misses the point, for in making it available to its own stockholders the corporation is realizing the appreciation, and nothing more is necessary. It is our view that the addition to surplus on account of the increased value and the distribution of this increased value in satisfaction of the company's general liability to its stockholders, are the evidence that the gain has been real-

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[2] The proposition of taxing distributions in kind by corporations on a more equitable basis received favorable consideration by a subcommittee of the Committee on Ways and Means of the House of Representatives, but was not finally recommended because "no plan has been devised which overcomes constitutional objections." Preliminary Report, submitted December 4, 1933, House Committee Print, 73d Cong., 2nd Sess., "Prevention of Tax Avoidance", Item (32) (c), p. 23.

In a Statement of the Acting Secretary of the Treasury commenting on this report it was said (Item (32) (c), p. 17):

> The Department submits that the treatment of corporate distributions in kind be not changed. Any taxation of such dividends to the corporation would, in the opinion of the Department, be unsound as an income-tax measure, and furthermore would be of doubtful constitutionality.

We do not share the doubts expressed above. If, as we contend, the corporation realized the appreciation in value, the constitutional question necessarily disappears.

ized, for it is incomprehensible how a corporation can distribute to its stockholders something which it has not itself received. Petitioner had an earned surplus equivalent to the value of the stock distributed. (R. 24.)

The derivation of income may be evidenced by other things than the receipt of tangible property, and where one receives economic benefits equivalent to actual receipt of income there is the legal equivalent of actual receipt of income which affords a basis for the tax. The cases involving constructive receipt are a familiar illustration of this principle. Many of them were collected and cited with approval in *Old Colony Tr. Co.* v. *Commissioner*, 279 U. S. 716, 729, where it was held that the payments by a corporation of its president's taxes constituted income to the officer, although he never received or had a right to receive the money. It was enough that it was used for his benefit. In *Maryland Casualty Co.* v. *United States*, 251 U. S. 342, there was no actual receipt during the taxable year, but a reserve which was already in the company's possession was released to the free use and benefit of the corporation, which was held to be the equivalent of receipt. Similar situations existed in *Charleston & W. C. Ry. Co.* v. *Burnet*, 50 F. (2d) 342 (App. D. C.), and *Chicago, R. I. & P. Ry. Co.* v. *Commissioner*, 47 F. (2d) 990 (C. C. A. 7th); and in each case a like decision was reached. In *American National Co.* v. *United States*, 274 U. S. 99, this Court apparently approved the company's practice

of reporting as income the interest which the company had set up as a liability on its books but was not required to pay because the notes were satisfied before maturity. In *United States* v. *Kirby Lumber Co.*, 284 U. S. 1, the question was presented whether income had been realized by a corporation which purchased its bonds at less than par. This Court held that the corporation made a clear gain, and said (p. 3):

> The defendant in error has realized within the year an accession to income, if we take words in their plain popular meaning, as they should be taken here.

In some respects this case is not unlike *United States* v. *Phellis*, 257 U. S. 156. There the taxpayer was a stockholder of a New Jersey corporation which transferred its assets for stock in a new corporation. The New Jersey corporation distributed to the taxpayer some of the new stock and its value was treated as income in his hands, despite the fact that the value of his new stock, plus the value of his New Jersey stock after the distribution, was no greater than the value of his New Jersey stock alone before the distribution. This Court said (p. 174):

> It was a part of the purpose and a necessary result of the plan of reorganization, as carried out, that common stock of the new company to the extent of $58,854,200 should be turned over to the old company, treated by it as assets *to be distributed as*

> *against its liability to stockholders for accrued surplus,* and thereupon distributed to them "as a dividend." The assent of the stockholders was based upon this as a part of the plan. (Italics ours.)

No cash dividend was declared in that case, but the dividend in stock of another corporation was treated as satisfying the corporation's general liability to stockholders for accrued surplus. A similar liability existed here, which was satisfied by the dividend in stock. Petitioner's investment increased in value; petitioner carried the increase to its surplus where it appeared as an asset; and we submit that petitioner realized the economic benefit that would have followed the actual receipt of the gain in cash. For an investment of $1,909 petitioner was able to pay its stockholders a dividend of $1,071,426.25, and we submit that petitioner thus realized the difference as gain, profit or income within the "plain popular meaning" of the words.

Eisner v. *Macomber,* 252 U. S. 189, does not militate against these views. The definition of income there announced is satisfied here. It was there held that the gain must be derived and realized from the investment. We submit that petitioner derived and realized a gain here because the gain was made available to it and petitioner was enabled to deliver it to its stockholders and thus serve its primary corporate function.

Our argument necessarily rests upon the relationship between the corporation and its stockholders. While separate entities for the purpose of the taxing statute, there is nevertheless a relationship which makes it possible for the corporate entity, without severing the appreciation, to utilize it by transferring it to its stockholders, who thus derive the gain from their corporation. A corporate distribution consisting of shares of another corporation is equivalent to the distribution of a like amount of money. This is certainly true from the standpoint of the stockholders (*Peabody* v. *Eisner*, 247 U. S. 347, 350), and we think it is equally true from the standpoint of the corporation. The value of the property at the time of distribution is the basis for gain or loss in the hands of the stockholders. Their accountability for other than derivative income begins only then. They account for all increase in value thereafter, and we submit that the appreciation while in the corporate custody must be accounted for by the corporation.

Nor would the rule for which we contend open any door to tax avoidance. Under the present decisions a corporation may take a loss upon the payment of a dividend by the simple device of first declaring a cash dividend in the then market value of property and thereafter paying the dividend by the distribution of property which has cost more. *Callanan Road Improvement Co.* v. *Commissioner*, 12 B. T. A. 1109; *Bacon-McMillan Veneer Co.* v. *Commissioner*, 20 B. T. A. 556. Thus, under the

present rule losses may be taken by paying dividends in property which has declined in value; but, if the decision below is correct, the converse is not true, and there can be no tax upon the distribution by a dividend of property which has enhanced in value. The vice of this situation is obvious, for it establishes a rule which depends upon the form of the dividend declaration and thus puts in the hands of a corporation the power to use the rule in a manner which will always work to its advantage. A distinction depending upon the form of a corporate resolution is unreal. There is no difference of substance. In both cases the dividend is paid from corporate surplus and the stockholders are chargeable with income measured by the market value of the property received. From the corporation's standpoint the question is whether or not the increased value has become available to it. This cannot depend upon the form of the dividend declaration. We think it should depend upon whether the payment of the dividend is a disposition—a corporate use from which the corporation realizes the fruits of the investment.

The question which confronted this Court in *Burnet* v. *Wells,* 289 U. S. 670, turned upon the use to which certain income was put. There the income of a trust was attributed to the grantor insofar as it had been applied to the maintenance of insurance on his life, because the use to which it was put gave him (p. 679) "something fairly to be dealt

with as equivalent to ownership". The decision that the income was used for his benefit was thus stated (pp. 680–681):

> He devoted it at the same time to the preservation of his own contracts, to the protection of an interest which he wished to keep alive. The ends to be attained must be viewed in combination. True he would have been at liberty, if the trusts had not been made, to put an end to his interest in the policies through nonpayment of the premiums, to stamp the contracts out. The chance that economic changes might force him to that choice was a motive, along with others, for the foundation of the trusts. In effect he said to the trustee that for the rest of his life he would dedicate a part of his income to the preservation of these contracts, so much did they mean for his peace of mind and happiness. Income permanently applied by the act of the taxpayer to the maintenance of contracts of insurance made in his name for the support of his dependents is income used for his benefit in such a sense and to such a degree that there is nothing arbitrary or tyrannical in taxing it as his.

The relation between the parties and the tendency of the transfer to give relief from obligations which are recognized as binding by normal men and women are facts to be considered in determining tax liability. *Burnet* v. *Wells, supra,* p. 682. In the light of these principles, we submit that the increased value here involved was utilized by peti-

tioner "in such a sense and to such a degree" that there was the legal equivalent of its realization; for petitioner thus satisfied its obligation to account at some time to its stockholders for this $1,909 investment and its increment.

It is clear that petitioner used the increased value for a corporate purpose, and was thereby enabled to pay its stockholders $1,071,426.25. Thus was petitioner serving the principal end for which it was organized—to earn profits which it could distribute to its stockholders—and we submit that in so justifying the hopes of its organizers this economic entity, called a corporation, truly derived an economic gain.

We have been contending that the form of the dividend declaration is not important. However, if the distinction is sound between (a) satisfying a cash dividend by a payment in property and (b) the distribution of a dividend in property without the prior declaration of a cash dividend, we submit that in appreciating the actual value of the stock on its books and declaring a dividend in the amount of that appreciation, the petitioner was declaring a cash dividend.

Upon the declaration of a cash dividend a corporation becomes indebted to its stockholders in the amount declared. *Flynn* v. *Haas Bros.*, 20 F. (2d) 510, 511 (C. C. A. 9th); *Staats* v. *Biograph Co.*, 236 Fed. 454 (C. C. A. 2d); *Hopper* v. *Sage*, 112 N. Y. 530, 533–534, 20 N. E. 350, 351; *King* v. *Paterson and Hudson River Railroad Co.*, 29 N. J. L. 82,

affirmed, 29 N. J. L. 504. Accordingly, when it satisfies such a debt by distributing property which has cost less than the amount of the declared dividend, a corporation has satisfied a specific obligation for less than its face, and has realized income upon the principle of the *Kirby Lumber Co.* case, *supra.* The difference between the amount of the liability satisfied and the cost of the property used for the purpose represents income derived by the corporation just as much as if it had sold the property for cash. In effect the transaction is a sale of the property for the debt and the amount received, to wit, the debt, less the cost of the property, constitutes taxable income.

Here the petitioner's officers had determined that the Islands Edison stock had increased in value from the original cost of $2,000 in January, 1927, to an amount of $1,122,500, justifying an increase in surplus of the difference. (R. 3.) There could be little doubt that this was the fact, since there was a purchaser ready and willing to buy at the larger figure. By corporate resolution the petitioner credited to surplus the appreciation in value and then declared a dividend in the amount of $1,071,426.25 out of such surplus. The petitioner thus recognized that it had sufficient surplus to support a dividend of $1,071,426.25 and declared a dividend of that amount.

We submit the circumstance that the obligation was declared to be payable in a certain manner, that is, in "Common Stock of the Islands Edison

Company at a valuation of $56.12½ a share" (R. 12–13), does not change the fact that an obligation of a specific amount was incurred by the petitioner. Because of this recital the petitioner had the right to satisfy the obligation by transferring the Islands Edison Company stock in accordance with the description. But if it refused to do so or put it beyond its power to pay in such manner, the stockholders could recover the specific sum declared. Cf. *Beckwith* v. *Sheldon*, 168 Cal. 742; *Whitsett* v. *Forehand*, 79 N. C. 230; *Heywood* v. *Heywood*, 42 Me. 229. We contend that the dividend resolution resulted in a situation in which the petitioner created an obligation of a specific amount, reserving the right to pay in a certain manner. When such a situation obtains, the stock is not distributed as a dividend in kind but is delivered in payment or discharge of a debt due from the corporation to the stockholders. In this respect the case differs from *First Sav. Bank of Ogden* v. *Burnet*, *supra*.

The case of *The State* v. *Balt. and Ohio R. R. Co.*, 6 Gill (Md.) 363, upon which the court relied, is not authority against our contention. There the corporation had declared a dividend of 3% to be paid in cash to holders of less than 50 shares, and one-third in cash and two-thirds in bonds to holders of more than 50 shares. The court held that a larger stockholder could not recover the whole of its dividend in cash where it relied upon the dividend declaration as the basis of its action, since thereby it ratified the dividend as declared. But in

that case the corporation did not deny the liability to pay in bonds, nor did it appear that the stockholder had demanded or had been refused payment in such a medium. The court did not hold that the stockholder would have no right to demand cash if the corporation had refused or was unable to pay in the manner indicated, since that question was not involved.

The Board's decision is directly contrary to its former decision in *Bacon-McMillan Veneer Co.* v. *Commissioner, supra.* There the corporation directors resolved that "a fifty percent dividend be declared, and made payable in Liberty Loan Bonds in denominations of $1,000.00 each, at their market value this date, and all odd hundreds of dollars and cents in cash" (p. 557); and the resolution was carried into effect. The Board held that this constituted the creation of an obligation and a satisfaction thereof by payment in bonds, giving rise to taxable income. We contend that this represents the correct view, and it should have been followed by the Board and by the Circuit Court of Appeals in the instant case.

Commissioner v. *Columbia Pacific S. Co.*, 77 F. (2d) 759 (C. C. A. 9th), deals only with the question whether the form of the dividend was such as to create a cash liability which was satisfied at a profit. So far as the form of the dividend resolution is concerned, the facts in the two cases are not distinguishable and we submit that the decisions are unsound.

II

THE SUBSTANCE OF THE TRANSACTION WAS A SALE BY PETITIONER AND THE DISTRIBUTION OF CASH TO THE STOCKHOLDERS

In the alternative, and if petitioner failed to realize a gain by using the appreciation to satisfy a liability, then we contend that the sale must be attributed to petitioner.

There was an investment by petitioner in stock which increased in value while still in its hands. It carried the increase to its surplus, where it appeared as an asset. There was a sale by which the increase in value was realized, and while petitioner did not actually receive the cash consideration, it did receive every economic benefit that would have followed the actual receipt of the cash.

The sale would not have been made without the distribution to the stockholders; the distribution would not have been made without the sale. Since the sale could only have been made by delivery of all of the stock, it is extremely unlikely that petitioner would have distributed part of the stock if it would have jeopardized its opportunity to realize upon the 910 shares it retained.

It was clearly intended to give the stockholders cash, and petitioner made arrangements accordingly. The petitioner turned over the property to the stockholders, having arranged to supply the purchaser. Having arranged for a sale, petitioner introduced a wholly artificial step into the transac-

tion. The stockholders took the property, with a sales contract ready for their signatures, and they completed the sale in pursuance of petitioner's plan.

We think it is necessary to view the transaction as a whole and that a single transaction does not change its character because it involves separate steps. The word "transaction", this Court has said, "is a word of flexible meaning. It may comprehend a series of many occurrences, depending not so much upon the immediateness of their connection as upon their logical relationship." *Moore* v. *N. Y. Cotton Exchange,* 270 U. S. 593, 610. By accepting the petitioner's plan the stockholders became parties to it, and it is unnecessary that two steps so intimately related as these should be treated as if they had no connection. We submit that the two steps in the marketing of this stock were so welded together as to constitute one transaction, and that in substance petitioner sold its stock and distributed cash to its stockholders.

Applying the principle that the substance of the transaction must prevail over the form, the courts have not hesitated to treat separate steps in a preconceived plan as parts of a single transaction.

In *Tulsa Tribune Co.* v. *Commissioner,* 58 F. (2d) 937 (C. C. A. 10th), it was held that the purchase of a newspaper in November, 1919, and its transfer in 1920 to a corporation formed by the purchaser was a single transaction. The court said (p. 940):

> As it seems to us, the attempt to break this transaction up into two elements by saying that Jones bought the property and then transferred it to the corporation in exchange for its capital stock is not only unfair, but untrue.

It was held that the corporation issued its stock for cash.

In *Prairie Oil & Gas Co.* v. *Motter,* 66 F. (2d) 309 (C. C. A. 10th), the taxpayer purchased the stock of the Olean Petroleum Company for cash. The next day (April 1st) the Olean Petroleum Company transferred its assets to the taxpayer and dissolved. In answer to the contention that the purchase of the stock of Olean and the transfer of Olean's assets should be separately considered, the court said (p. 311):

> To avoid this conclusion the collector then undertakes to separate the component parts of this single transaction. He ignores the fact that the contract declares the purpose of the transaction to be the acquisition of the leases; that possession of the leases was delivered as of a date prior to the contract; that the Olean had $700,000 of other assets not bargained for or acquired; that the stock was delivered under an optional arrangement to accomplish the transfer of the leases; and that the charter was surrendered the day after the stock was delivered. His position is that the court should close its eyes to the events prior to April 1st, and consider only the fact that the Prairie owned all the

> Olean stock on that day; that it then transferred to the Prairie all its properties in consideration of a cancellation of its stock. If a taxpayer sought to avoid a tax on the profits of such a sale as this by asking the Commissioner to ignore the actualities, he would shortly and properly be reminded that taxation is an intensely practical matter and that the substance of the thing done, and not the form it took, must govern.

Accordingly, it was held that Olean's assets were acquired for cash.

In *American Security & Trust Co.* v. *Tait*, 5 F. Supp. 337 (Md.), a transaction involving the merger of a bank and a trust company took the form of a transfer of the bank's stock to trustees; a transfer of the bank's assets to the trust company for cash equivalent to $400 per share of bank stock; the employment of the cash to purchase the trust company's stock; and finally a distribution of the trust company's stock to the stockholders of the bank. The taxpayer contended that the transaction was a sale of bank stock at $400 per share; but the court held that the entire transaction must be taken into account, and said (p. 340):

> This contention is clearly untenable. In effect it divides an indivisible contract into two separate contracts, one of sale of the Bank stock at $400 a share and the other a subscription at the par of $100 to four shares of Trust Company stock, each having a market value of $220 per share. To treat an

> entire and indivisible contract this way not only violates the elementary rules of the construction of contracts but from the economic standpoint, injects an atmosphere of unreality in erecting the hypothesis that a stockholder who could obtain a value equal to $880 per share for his Bank stock actually sold it for $400.

The statute taxes the gain realized on a sale or other disposition. Here it is clear that there was a sale upon which gain was realized, and although care was taken to complete the transaction by the signatures of the stockholders, all the other essentials were completed by the corporation. In such a situation we think the statute is broad enough to attribute the sale to the corporation. In *Horning* v. *District of Columbia,* 254 U. S. 135, this Court sustained a conviction for doing business as a pawn broker in the District of Columbia without a license, although the loans were made in every case outside the District of Columbia. This Court held that the statute was not confined to cases where the whole business was done in the District of Columbia, and said (p. 137):

> If an essential part of it is done there and a Washington office is used as a collecting centre, it does not matter that care is taken to complete every legal transaction on the other side of the Potomac.

We submit that if a criminal statute (c. 26, 37 Stat. 657, Sec. 1) making it an offense "to en-

gage in the District of Columbia in the business of loaning money * * * without procuring license" was broad enough to cover loans initiated in the District of Columbia but consummated outside, then *a fortiori* is this taxing statute, requiring no scienter, to be construed as equally applicable to sales initiated by this petitioner even though consummated by its stockholders.

The line between a corporation and its stockholders is not so well marked and so clearly defined that a plan of sale conceived on the corporate side and there carried to a point just short of consummation must be deemed to have wholly occurred on the stockholders' side merely because care is taken to complete it there.

The court below found justification for the tax by treating the stockholders as agents in making the sale. We do not think it is important or necessary that a legal classification be applied to this situation, but much support for the agency concept can be found in the decisions.

This is not a case in which a corporation had distributed assets to its stockholders, who thereafter find and sell to a purchaser. This is a case in which the petitioner found a purchaser, arranged the terms of sale, and, through its counsel, prepared the written agreement for its stockholders to sign. One of the terms of sale was that the title must pass through the stockholders in order that the petitioner might escape the income tax on the gain,

i. e., the appreciation of the value which had occurred while it held the stock. The plan required the delivery of all of the stock. All of the stockholders joined in and ratified the plan by signing the contract which petitioner had prepared. There is nothing in the record to indicate that the petitioner would have made a distribution of the stock to its stockholders except as a step in a larger plan of sale; the clear inference is otherwise. The plan, we submit, was one of sale; the distribution was incidental and was a method of passing the profit on to the stockholders; this latter would probably have occurred later, and petitioner might have been confronted with the necessity of making it shortly thereafter under the compulsion of Section 220 of the Revenue Act of 1926 (c. 27, 44 Stat. 9; U. S. C. App., Title 26, Sec. 961), or Section 104 of the Revenue Act of 1928.

Under this factual situation, we submit that the stockholders were mere agents in the transaction. Cf. *Beers* v. *McNaught*, 162 N. Y. Supp. 514. In determining whether agency does, or does not, exist "forms are not important. Courts will look to the actual transactions." *Fenner & Beane* v. *Holt*, 2 F. (2d) 253 (C. C. A. 5th), certiorari denied, 267 U. S. 605. Agency is frequently implied. *Radio Corporation of America* v. *Radio Audion Co.*, 284 Fed. 581 (Del.). It is not necessary that the principal retain control over the agent. *S. B. McMaster, Inc.* v. *Chevrolet Motor Co.*, 3 F. (2d)

469, 476 (E. D. S. C.). Cf. *Rollins* v. *McDonald*, 7 F. (2d) 422 (C. C. A. 1st). It is not necessary that the parties understand the relationship to be one of agency. *Daugherty* v. *Wiles*, 207 S. W. 900, 902 (Tex.). No express appointment or acceptance is necessary to the relationship. *B. & O. R. Co.* v. *Steel Co.*, 138 Md. 604, 611; *Wilson* v. *Haun*, 97 Kan. 445. It is not necessary that the agent be compensated for his services. *Napier* v. *Patterson*, 198 Iowa 257.

Where one person, in order to shield himself from liability, uses another as a figurehead in making a sale, the relationship of principal and agent exists, and the sale will be considered as made by the principal. *Farnham* v. *Akron Tire Co.*, 98 Wash. 484. This result has been reached in substance in numerous cases. See *Asiatic Petroleum Co.* v. *Commissioner* (C. C. A. 2d), decided August 16, 1935, not yet officially reported, but may be found in C. C. H. (1935), Vol. 3–A, p. 10,372; *Rand* v. *Helvering*, 77 F. (2d) 450 (C. C. A. 8th); *Atkins* v. *Commissioner*, 76 F. (2d) 387 (C. C. A. 5th); *Shoenberg* v. *Commissioner*, 77 F. (2d) 446 (C. C. A 8th)[3]; *Esperson* v. *Commissioner*, 49 F. (2d) 259 (C. C. A. 5th), certiorari denied, 284 U. S. 658. We submit that the court below was correct in inferring that the stockholders acted as agents for

[3] Certiorari denied October 14, 1935, No. 141, October Term, 1935.

the petitioner in passing the stock over to the purchaser.

The petitioner used its stockholders as a channel or conduit for the passage of title from itself to the purchaser. This was a formalistic intermediate step in the sale; it was not germane to the main transaction. Such a step in the transaction of sale will be ignored and the sale will be treated as made by the petitioner. *S. A. MacQueen Co.* v. *Commissioner,* 67 F. (2d) 857 (C. C. A. 3d); *Hellebush* v. *Commissioner,* 65 F. (2d) 902 (C. C. A. 6th); *Burnet* v. *Lexington Ice & Coal Co.,* 62 F. (2d) 906 (C. C. A. 4th); *Taylor Oil & Gas Co.* v. *Commissioner,* 47 F. (2d) 108 (C. C. A. 5th).

The case of *Gregory* v. *Helvering,* 293 U. S. 465, relied upon by the petitioner (Br. 17), supports, rather than militates against, the Government's position herein. That case recognized that the steps taken by a taxpayer to evade or avoid income tax must be real substantial transactions. As we have pointed out above, income tax cases are determined by a consideration of the substance, rather than the form, of a given transaction. The method of avoidance used in this case is as unsubstantial and as lacking in reality as the method used in the *Gregory* case. The case of *United States* v. *Isham,* 17 Wall. 496, likewise does not militate against our contentions herein. The form, instead of the substance, controls in a documentary stamp tax case such as the *Isham* case. In other words, the stamp

tax is imposed upon the *form* of a document. What "the law permits" in a stamp tax case may not be permitted in an income tax case, and *vice versa,* by reason of the inherent differences between the two types of taxes.

The case of *Chisholm* v. *Commissioner* (C. C. A. 2d), decided July 8, 1935, not yet officially reported; but may be found in C. C. H. (1935), Vol. 3–A, p. 10,227, conflicts with the decision below on this point. The case is also in substantial conflict with *Gregory* v. *Helvering, supra.* We submit that the decision in the *Chisholm* case is unsound. A petition for certiorari was filed October 15, 1935, No. 519.

It is contended that the court below had no authority to decide that petitioner realized income from the sale because the issue presented to the Board of Tax Appeals was whether petitioner realized income from the dividend payment. We submit that the court below had the power and authority to consider and decide the case upon this theory. The assignments of error (R. 44) were sufficiently broad to bring before the court any theory, based upon the record, which would support the deficiency. The theory was based entirely upon the facts as stipulated, and was in support of the affirmative of the only issue in the case, i. e.: Was the amount of the deficiency correctly determined by the court? The method of arriving at the amount of the deficiency was not the issue. *Hughes* v. *Commissioner,* 38 F. (2d) 755, 757 (C. C. A.

10th); *Atlanta Casket Co.* v. *Rose,* 22 F. (2d) 800 (C. C. A. 5th). This Court has upheld the jurisdiction of Circuit Courts of Appeals to consider a cause upon a theory different from the one advanced before the trial tribunal. *Friend* v. *Talcott,* 228 U. S. 27, 36. The Circuit Courts of Appeals have frequently considered tax cases upon theories different from those advanced by the parties before the Board of Tax Appeals. This has been done at the instance of the Commissioner [*Childers* v. *Commissioner* (C. C. A. 9th), decided August 12, 1935, not yet officially reported, but may be found in C. C. H. (1935), Vol. 3–A, pp. 10,359, 10364; *Lewis-Hall Iron Works* v. *Blair,* 23 F. (2d) 972 (App. D. C.), certiorari denied, 277 U. S. 592; *Hurwitz* v. *Commissioner,* 45 F. (2d) 780 (C. C. A. 2d)], and at the instance of taxpayers [*Virginia-Lincoln Furniture Corp.* v. *Commissioner,* 56 F. (2d) 1028, 1033 (C. C. A. 4th); *Underwood* v. *Commissioner,* 56 F. (2d) 67 (C. C. A. 4th); *Seufert Bros. Co.* v. *Lucas,* 44 F. (2d) 528, 530 (C. C. A. 9th)]. In *Helvering* v. *Gregory,* 69 F. (2d) 809 (C. C. A. 2d), affirmed *sub nom., Gregory* v. *Helvering,* 293 U. S. 465, the Circuit Court of Appeals decided the case upon a theory different from the theories advanced on both sides. The cases relied upon by the petitioner (Br. 21) merely show that the question is one of practice and that this Court generally declines to consider a theory which has not been considered below. That it is a question of practice only, and does not involve a limitation

of judicial power, is clear from *Wuchter* v. *Pizzutti*, 276 U. S. 13; *Cole* v. *Ralph*, 252 U. S. 286; and *Chase, Jr.* v. *United States*, 256 U. S. 1.

When the trial tribunal has decided a cause upon one theory and the Circuit Court of Appeals has decided it upon another theory, this Court will consider both theories. See *Friend* v. *Talcott, supra.* We submit that the Circuit Court of Appeals had the right to consider the question upon the new theory and that this Court may consider both theories.

The petitioner insists that when the court decided that the facts showed the stockholders to be agents for the petitioner in making the sale (R. 58), it decided a question of fact (Br. 18–20). In this we submit the petitioner is in error.

Where the evidence is undisputed, the question of agency, its character and extent, are questions of law for the court. *Clark & Barker* v. *Eufaula Brick Works*, 205 Ala. 545, 547; *Masters* v. *Walker*, 89 Ore. 526, 530. Cf. *Whitson* v. *Pacific Nash Motor Co.*, 37 Idaho 204; *Fulton* v. *W. R. Grace & Co.*, 143 Va. 12; *Central Mortgage Co.* v. *Michigan State Life Ins. Co.*, 43 Okla. 33. This Court apparently treated the question of agency as one of law in *Willcox & Gibbs Co.* v. *Ewing*, 141 U. S. 627.

The court below was concerned with the ultimate conclusion as to whether or not the facts as revealed by the stipulation supported the Commissioner's determination. In reaching this ultimate conclusion the court took those facts and considered

their legal effect. This inquiry was concerned with the legal effect of the facts as agreed upon. This was a question of law which the court below had jurisdiction to decide on review. *United States* v. *Pugh*, 99 U. S. 265; *Winton* v. *Amos*, 255 U. S. 373, 395–396; *Botany Mills* v. *United States*, 278 U. S. 282; *Ox Fibre Brush Co.* v. *Blair*, 32 F. (2d) 42, 45 (C. C. A. 4th), affirmed *sub. nom. Lucas* v. *Ox Fibre Brush Co.*, 281 U. S. 115; *Cohen* v. *Commissioner*, 31 F. (2d) 874, 876 (C. C. A. 4th); *Iowa Bridge Co.* v. *Commissioner*, 39 F. (2d) 777 (C. C. A. 8th); *St. Paul Abstract Co.* v. *Commissioner*, *supra*, (p. 226). We submit that when the court below decided that the stockholders acted as agents for the petitioner in making the sale, it decided only a question of law.

CONCLUSION

The decision of the court below should be affirmed, either upon the ground that petitioner realized the income upon the dividend payment or that the sale should be attributed to petitioner.

Respectfully submitted.

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OCTOBER 1935.

APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791, 797, 815, 818:

SEC. 22. GROSS INCOME.

(a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

* * * * *

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

(a) *Computation of gain or loss.*—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.

* * * * *

(c) *Amount realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

* * * * *

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; * * *

* * * * *

Treasury Regulations 74 (promulgated under the Revenue Act of 1928):

ART. 69. *Sale of capital assets by corporation.*—Where property is acquired and later sold for an amount in excess of the cost or other basis, the gain on the sale is income. Where, then, a corporation sells its capital assets in whole or in part, it shall include in its gross income for the year in which the sale was made the gain from such sale computed as provided in sections 111–113 and articles 561–604. * * *

ART. 71. *Gross income of corporation in liquidation.*—* * *. No gain or loss is realized by a corporation from the mere distribution of its assets in kind in partial or complete liquidation, however they may have appreciated or depreciated in value since their acquisition. * * *.

U. S. GOVERNMENT PRINTING OFFICE: 1933

FILE COPY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1934.

No. 811.

GENERAL UTILITIES & OPERATING COMPANY,
Petitioner,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS, FOURTH CIRCUIT.

MOTION FOR LEAVE TO FILE BRIEF AS AMICI CURIAE AND BRIEF.

LAURENCE ARNOLD TANZER,
JOHN W. TOWNSEND,
As Amici Curiae.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1934.

No. 939.

GENERAL UTILITIES & OPERATING COMPANY,
Petitioner,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS, FOURTH CIRCUIT.

MOTION FOR LEAVE TO FILE BRIEF AS AMICI CURIAE.

Now come Laurence Arnold Tanzer and John W. Townsend, attorneys and counsellors of this court, and, representing that the petition for certiorari herein involves matters of general interest affecting the rights of clients represented by them, pray leave to file the annexed brief as *amici curiae* in support of the petition for certiorari herein, counsel for both parties consenting thereto.

Respectfully submitted,

LAURENCE ARNOLD TANZER,
JOHN W. TOWNSEND,
As Amici Curiae.

BRIEF OF AMICI CURIAE IN SUPPORT OF PETITION FOR CERTIORARI.

The purpose of this brief is to call to the Court's attention the general importance of the question presented, and the dangerous and far-reaching character of the precedent established by the decision of the Circuit Court of Appeals.

The question presented is whether the distribution of property by a corporation to its stockholders, and the subsequent sale of the property by the stockholders, can be disregarded, and the sale treated as if made by the corporation, solely because the transaction was motivated by a desire to avoid double taxation.

The facts are undisputed, having been stipulated by the parties and found by the Board of Tax Appeals. The petitioner here would not make the proposed sale, because it would involve a tax payable by petitioner, and a second tax payable by its stockholders upon the distribution to them of the proceeds. Instead, it distributed the property to its stockholders, and they made the sale.

The holding of the Circuit Court of Appeals that "The sale of the stock in question was, in substance, made by the respondent company, through the stockholders as agents or conduits through whom the transfer of the title was effected" is contrary to the facts as stipulated and found, and amounts to a finding by the Circuit Court of Appeals of a fact (that the stockholders acted as agents for the corporation) not warranted by the evidence nor found by the Board, and which the Circuit Court of Appeals had no power to make (*Helvering* v. *Rankin*, ... U. S. ...., decided April 29, 1935).

The only justification offered by the Circuit Court of Appeals for thus disregarding the actual transaction is that "The transaction was deliberately planned and carried out for the sole purpose of escaping taxation * * * the details were worked out for the express and admitted purpose of avoiding the payment of the tax."

The court below thus holds that what the parties have actually done can be disregarded solely because done with the motive to reduce taxation. That holding is subversive of well settled principles: if allowed to stand, the validity and effect of every transaction, and the possible tax liability resulting therefrom, will be open to question, depending on future litigation and determination of the motive, rather than of the character of the transaction itself.

The decision is in direct conflict with the rule laid down by this Court in *United States* v. *Phellis*, 257 U. S. 156, 172, that "what was done, rather than the design and purpose of the participants, should be the test." The decision is likewise in direct conflict with the principle enunciated by this Court in *Gregory* v. *Helvering*, 293 U. S. 465, 469, that "The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted. *United States* v. *Isham*, 17 Wall., 496, 506; *Superior Oil Co.* v. *Mississippi*, 280 U. S. 390, 395-6; *Jones* v. *Helvering*, 63 App. D. C. 204, 71 F. (2d) 214, 217. But the question for determination is whether what was done, apart from the tax motive, was the thing which the statute intended."

In the *Gregory* case the Court, inquiring into the actual transaction, as distinguished from the motive, held that a transfer of assets by one corporation to another, whose stock was distributed to the taxpayer, was not a reorganization within the meaning of the statute there under consideration because it was "an operation having no business or corporate purpose," and sustained the Commissioner in holding the distribution to be a taxable dividend. Applying the same test to what was done in the case at bar, the distribution by the petitioner to the stockholders was a distribution of corporate property, taxable to the stockholders as a dividend, and vesting the ownership of the property distributed in them; the subsequent sale was a sale by the stockholders and not by the corporation.

In the *Gregory* case this Court relied upon and cited with approval the decision of the Court of Appeals of the District of Columbia in *Jones* v. *Helvering*, 71 F. (2d) 214, 217, certiorari denied 293 U. S. 583, which case is directly in point here. In that case the stockholders of a closely held corporation, for the admitted purpose of reducing taxation by registering a loss resulting from the depreciation in value of securities owned by them, sold the securities to the corporation. The court rejected the view that the admitted purpose to escape taxation, or the fact that the stockholders were dealing with a corporation wholly controlled by them, could give rise to tax liability, and sustained the taxpayers in deducting the loss, saying at page 217:

> "That brings us back to the single query whether the possession of the power to do the thing the Board denounces, that is to say, the ability through stock ownership to control the corporate action, is sufficient to make a sale otherwise unobjectionable subject to be treated as a nullity for tax purposes. The only argument that can be urged in the affirmative is that it is against public policy to allow a taxpayer to incorporate his business in such a way as through manipulation or transfers between himself and it he can place the one or the other beyond the reach of the taxing statutes, and there is great force to the argument. But, so far as we know, in cases where the element of fraud in fact is lacking, it has been the invariable holding that a taxpayer may resort to any legal methods available to him to diminish the amount of his tax liability. *Bullen* v. *State of Wisconsin*, 240 U. S. 625, 630, 36 S. Ct. 473, 60 L. Ed. 830. In *Iowa Bridge Co.* v. *Commissioner, supra*, at page 781 of 39 F. (2d), Judge Gardner, speaking for the Court of Appeals in the Eighth Circuit, said: 'In fact, it is held that even though the transaction is a device to avoid the burden of taxation, or to lessen that burden, it is not for that reason alone illegal.' See also *United States* v. *Isham*, 17 Wall. 496, 506, 21 L. Ed. 728."

To the same effect see *Commissioner* v. *Dyer*, 74 F. (2d) 685 (C. C. A. 2).

In disregarding the distinction between the corporate entity and the stockholders and attributing to the corporation acts which on the facts stipulated and found were the acts of its stockholders, the decision is in conflict with a long line of decisions of this Court, cited in *Jones* v. *Helvering, supra.*

It is respectfully submitted that the decision below is an erroneous and dangerous precedent, and that certiorari should be granted.

LAURENCE ARNOLD TANZER,
JOHN W. TOWNSEND,
As Amici Curiae.

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Supreme Court of the United States.

OCTOBER TERM, 1935.

No. 41.

GENERAL UTILITIES AND OPERATING COMPANY,

Petitioner,

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF OF *AMICUS CURIAE.*

RUSSELL D. MORRILL,
Amicus Curiae.

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Supreme Court of the United States.

OCTOBER TERM, 1935.

No. 41.

GENERAL UTILITIES AND OPERATING COMPANY,
Petitioner,

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF OF *AMICUS CURIAE*.

This case comes up on writ of certiorari to the United States Circuit Court of Appeals for the Fourth Circuit.

Questions Presented.

Upon the record the following questions are presented to which this brief is addressed:

1. Does a corporation realize a taxable gain upon the distribution to its stockholders as a dividend in kind of property which has appreciated in value in its hands?

2. If not, was the sale of stock under the circumstances here made by or for the account of the corporation rather than the stockholders?

Outline of Argument.

I. A corporation realizes no taxable gain or income from a distribution of a dividend in kind out of surplus due to appreciation in value of its assets.

(a) No money or other property having a fair market value is received.

(b) No assets are freed of liabilities to the general use of the corporation and the corporation has nothing which it did not possess before disposition.

II. The sale of stock in this case was made by the stockholders for their own account and the corporation realized no taxable gain on such sale.

I.

A corporation realizes no taxable gain or income from a distribution of a dividend in kind out of surplus due to appreciation in value of its assets.

Gross income, within the meaning of the Revenue Act of 1928 (Section 22, *infra*, p. 12) and the Sixteenth Amendment to the Constitution, includes "gains * * * derived * * * from sales, or dealings in property * * * growing out of the * * * use of * * * such property * * * and including income derived from any source whatever." Under the Revenue Act of 1928 (Section 111(a), *infra*, p. 13), with exceptions not here involved, "* * * gain from the sale or other disposition of property shall be the excess of *the amount realized* therefrom over the basis provided in Section 113 * * *." *"The amount realized* from the sale or other disposition of property shall be *the sum of money received plus the fair market value of the property* (other than money) *received.*" (Section 111(c), *infra*, p. 13). (Emphasis supplied.) The basis under Section 113 (*infra*, p. 13), so far as here concerned, is the cost of property.

When, as here, a corporation distributes to its stockholders by way of a dividend in kind, property which has appreciated in value, it receives no sum of money or property having a fair market value, and, therefore, there is no amount realized. The corporation has disposed of property having a cost, but there is nothing *realized* thereon within the definition in the law. The essential element of income is lacking in such a transaction. There is nothing "of exchangeable value proceeding from the property" and "coming in, being 'derived', that is, received or drawn by the recipient (the taxpayer) for his separate use, benefit and disposal."

Eisner v. *Macomber*, 252 U. S. 189, 207;
First National Bank of Ogden v. *Burnet*, 53 Fed. (2d) 919 (C. A. D. C.).

The statute specifically requires the amount realized to be in money or property having a fair market value. Admitting that there has accrued to the capital of the corporation an increment or growth in its investment and a surplus, in the sense of an excess of value of assets over liabilities, and admitting that it has been able to make this unsevered increment available to its stockholders and has thereby gained an economic benefit, it still falls short of receiving taxable gain or income as defined by the statute and the cases. "The income tax laws do not profess to embody perfect economic theory. They ignore some things that either a theorist or a business man would take into account in determining the pecuniary condition of the taxpayer." *Weiss* v. *Wiener*, 279 U. S. 333, at page 335.

As stated by this court in *Merchants Loan & Trust Co.* v. *Smietanka*, 255 U. S. 509:

> "In determining the definition of the word 'income' thus arrived at" (referring to the definition laid down in *Eisner* v. *Macomber*, *supra*), "this court has consistently refused to enter into the refinements of lexicographers or economists and has approved, in the definitions quoted, what it believed to be the commonly understood meaning of the term which must have been in the minds of the people when they adopted the Sixteenth Amendment to the Constitution."

See also *Eaton* v. *White*, 70 Fed. (2d) 449, 452 (C. C. A. 1), where the court stated:

> "The statute emphasizes that taxable gain is 'the amount realized' in money received and fair market value of the property received. We know of no case that recognizes the enhancement of the market value of property already possessed as equivalent to the receipt of property with a market value. • • •
>
> These situations only emphasize the advisability and necessity of adhering to the well established rules and

principles in dealing with legally established corporate entities and the status and character of corporate shares. To abandon these moorings, would create difficulties and uncertainties more objectionable in their results than any seeming inequities which would be eliminated or prevented."

The distribution of appreciated property as a dividend in kind may be a disposition, but it is contended that it is not such within the meaning of the applicable statute. The rule of *ejusdem generis* should be applied and disposition construed to mean a disposition analogous to a sale. *First National Bank of Ogden v. Burnet, supra.*

Congress has recognized that a distribution in kind did not result in taxable gain or loss to a corporation, and clearly indicated its intention that the language of the Revenue Acts should not be interpreted as giving rise to gain or loss on such a distribution. Preliminary Report of a Subcommittee of the Committee on Ways and Means, "Prevention of Tax Avoidance," House Committee Print, 73rd Cong. 2nd Sess., Item (32) (c), page 23.

A gift is a disposition of property but a regulation under the New York Income Tax Law to the effect that gain or loss resulted to the donor from a gift was held invalid in *People ex rel. Brewster* v. *Wendell,* 196 App. Div. (N. Y.) 613. See also, *People ex rel. Wilson* v. *Wendell,* 196 App. Div. (N. Y.) 596. In *Taft* v. *Bowers,* 278 U. S. 470, this Court recognized that a donor realized no taxable income by making a gift of property which had increased in value. The Treasury Department has ruled that the death of an individual does not work such a disposition of property as results in gain or loss. A. R. R. 249, 3 C. B. 145; O. D. 219, 1 C. B. 180; and O. D. 731, 3 C. B. 210, and yet, a father may receive substantial economic benefit from a gift or bequest to his children.

It has been the consistent interpretation of the Treasury Department that no gain or loss is realized by a corporation from the mere distribution of its assets in kind in partial or complete liquidation, however, they may have appreciated or

depreciated in value since their acquisition. Article 71 of Regulations 74 under the Revenue Act of 1928 and Article 548 of Regulations 69 and 65 under the Revenue Acts of 1926 and 1924. A corporation discharges its obligations to its stockholders as much by a distribution in liquidation of appreciated property as it does in the distribution thereof by an ordinary dividend. With respect to the realization of taxable income or gain, there is no real basis of distinction between a gift, bequest, distribution in liquidation and an ordinary dividend in kind.

Conditions under which deduction of losses is allowed by the law are distinguishable from those under which income or gain is realized.

> "The power to tax income like that of the new corporation is plain and extends to the gross income. Whether and to what extent deductions shall be allowed depends upon legislative grace; and only as there is clear provision therefor can any particular deduction be allowed."
>
> *New Colonial Ice Co., Inc.* v. *Helvering,* 292 U. S. 435, at pages 440, 442.

It is submitted, that a loss cannot be sustained under Section 111 (*infra,* p. 13), unless some amount is realized in money or property having a fair market value. However, deduction is allowed under Section 23 (c) and (f) (*infra,* p. 12) of losses sustained by means other than "sale or other disposition". The losses allowed in *United States* v. *S. S. White Dental Manufacturing Co.,* 274 U. S. 398, and *DeLoss* v. *Commissioner,* 28 Fed. (2d) 803 (C. C. A. 2nd), were sustained under conditions in no way analogous to the facts of the present case and under specific statutory provisions unrelated to Section 111 of the 1928 Act.

Income, too, may be realized other than by the sale or disposition of property. *Old Colony Trust Co.* v. *Commissioner,* 279 U. S. 716; *United States* v. *Boston & Maine R. Co.,* 279 U. S. 732; *Maryland Casualty Company* v. *United States,* 251 U. S. 342; *Charleston & W. C. Ry. Co.* v. *Burnet,* 50 Fed. (2d) 342; *United States* v. *Kirby Lumber Co.,* 284 U. S. 1.

Those cases have no application in the instant case. The corporation here received nothing on account of services performed, rent, or reduction or recovery on account of deductions from gross income in prior years. The dividend obligation is not a liability deductible from gross income. No liability was satisfied at less than face amount so as to release to the general uses of the corporation any assets previously offset by obligations.

In *Commissioner of Internal Revenue* v. *Rail Joint Co.*, 61 Fed. (2d) 751 (C. C. A. 2nd), the taxpayer, a New York corporation, in 1914 approved an appraisal of its assets which added $3,000,000 to its surplus account. It then declared a dividend payable in bonds and issued and distributed among its stockholders its own debenture bonds of a face amount of $2,000,000. In 1926 and 1927 some of these unmatured bonds were purchased by the corporation at less than face value. Such bonds were cancelled and the difference between the purchase price and the face value was credited to surplus. The question was whether the corporation realized a taxable gain when the bonds were purchased and cancelled.

The Court stated in its opinion, page 752:

> "In paying dividends to shareholders, the corporation does not buy property from them. Here *the respondent"* (corporation) *"never received any increment to its assets, either at the time the bonds were delivered or at the time they were retired.* * * * Hence it is apparent that the corporation received no asset which it did not possess prior to the opening and closing of the bond transaction, and it is impossible to see wherein it has realized any taxable income." (Italics ours.)

The corporation here received no asset in the transaction in question which it did not possess before.

The situation might well be different if the directors had declared a cash dividend and thereby incurred a fixed debt which could be recovered in cash by the stockholders and which could not be revoked by subsequent action of the directors. *Flynn* v. *Haas Bros.*, 20 Fed. (2d) 510 (C. C. A.

9th); *Staats* v. *Biograph Co.*, 236 Fed. 454 (C. C. A. 2nd); *Callanan Road Improvement Co.*, 12 B. T. A. 1109; *Bacon-MacMillen Veneer Co.*, 20 B. T. A. 556; *Fruit Belt Telephone Co.*, 22 B. T. A. 440.

However, the declaration of a dividend and the fixing of the amount, time and terms of payment thereof whether in stock, cash or property, are entirely within the discretion of the board of directors of a corporation and a court cannot substitute its judgment for that of the directors, if honestly exercised. *Liebman* v. *Auto Strop Co.*, 241 N. Y. 427, 433; *Richter & Co.* v. *Light*, 116 Atl. 600 (Sup. Ct. of Errors of Conn., March, 1922). If the declaration is conditional, the conditions will be enforced. *Tepfer* v. *Rival Gas & Electric Fixture Supply Co.*, 117 N. Y. S. 959 (Sup. Ct. Ap. Term, June, 1909, aff'd without opinion, 121 N. Y. S. 1149); *Bryant* v. *Mutual Life Insurance Co.*, 109 Fed. 748 (Cir. Ct., N. D., Tenn., May, 1901); *Hyams* v. *Old Dominion Copper Mining and Smelting Co.*, 89 Atl. 37 (Court of Chancery of New Jersey, November 1913); *Colorado* v. *Great Western Sugar Co.*, 29 Fed. (2d) 810.

Section 115(a), Revenue Act of 1928 (*infra*, p. 13), defines "dividend" as "any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913". Subdivision (b) of that section (*infra*, p. 13), provides that

> "For the purposes of this act, every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. * * *"

A corporation having earnings or profits accumulated after February 28, 1913, represented by cash or assets, which declares a dividend payable in cash, thereby creates a debt and divides and sets over to its stockholders a portion of its cash or property representing such accumulated earnings. A liability payable in cash is thereby imposed upon certain of the corporation's assets representing the previously realized and accumulated earnings or profits. *Flynn* v. *Haas Brothers*,

and *Staats* v. *Biograph Co., supra.* If the corporation then appreciates on its books an asset, thereby creating additional surplus and subsequently appropriates the appreciated asset to the satisfaction of the liability for the cash dividend which was in effect a lien upon the assets prior to the appreciation, it thereby releases assets previously covered by the obligation of the dividend to the general uses of the corporation. The assets so released are free in the hands of the corporation to be used in satisfaction of claims of creditors or for other purposes.

When, however, a dividend is not declared payable in cash but in certain identified property, even though the value of such property be stated, it is submitted that the obligation of the corporation is to distribute the particular property and not a sum of money. The obligation or liability is imposed upon only that particular item of property on which the corporation has never realized the gain and not on any other property representing earnings or profits previously accumulated. It is submitted that the delivery of the particular property regardless of fluctuations in its value between declaration and delivery satisfies the corporation's obligation and does not in any way add to the assets available for the general uses of the corporation. There is a vital distinction in the form of the dividend and the Court cannot substitute its discretion for that of the directors.

II.

The sale of stock in this case was made by the stockholders for their own account and the corporation realised no taxable gain on such sale.

This Court has been at great pains to point out time and again that a corporation is a legal entity and as such wholly different and distinct from its stockholders, and that a leading purpose of the incorporation laws and of those who act under them is to interpose a nonconductor, through which,

in matters of contract, it is impossible to see the men behind. *Eisner* v. *Macomber, supra; Klein* v. *Board of Supervisors,* 282 U. S. 19, 24; *Donnell* v. *Herring-Hall-Marvin Safe Co.,* 208 U. S. 267, 273; *Dalton, et al.* v. *Bowers,* 287 U. S. 404; *Cannon Mfg. Co.* v. *Cudahy Co.,* 267 U. S. 333.

In this case one of these entities, the petitioner, by proper corporate action, transferred and delivered title to property consisting of shares of stock to the stockholders without legally binding condition or restriction.

A corporation acts through its Board of Directors and officers; its property is not subject to the control or disposition of its members or stockholders; they have no power to sell or encumber the corporate properties, and, it is submitted, the corporation has no power to sell or encumber the property of its stockholders. *Sellers* v. *Greer,* 50 N. E. Rep. 246; *2 Cook, Stock, Stockh. & Corp. Law* (3rd Ed.) § 709; *Allemong* v. *Simmons,* 124 Ind. 199, 23 N. E. 768; *Humphreys* v. *McKissock,* 140 U. S. 304, 11 Sup. Ct. 779; *Hopkins* v. *Lead Co.,* 72 Ill. 373; *England* v. *Dearborn,* 141 Mass. 590, 6 N. E. 837; *Manufacturing Co.* v. *White,* 42 Ga. 148; *Russell* v. *McLellan,* 14 Pick. 63.

As stated by the Circuit Court of Appeals for the Second Circuit in *George H. Chisholm, Petitioner,* v. *Commissioner of Internal Revenue,* 79 Fed. (2) 14, certiorari denied November 11, 1935;

> "The decisions on which the commissioner relies are quite different; they concern sales in which the buyer did not gain dominion over the goods, but acted as a trustee or agent for the seller, the taxpayer. Such transactions contradict a sale, which presupposes that the seller loses not only title but control. *Esperon* v. *Com'r.,* 49 Fed. (2) 359 (C. C. A. 5); *MacQueen* v. *Com'r.,* 67 Fed. (2) 857 (C. C. A. 3); *Hellebush* v. *Com'r.,* 65 Fed. (2) 902 (C. C. A. 6); *Burnet* v. *Lexington I. & C. Co.,* 62 Fed. (2) 906 (C. C. A. 4); *Taylor G. & O. Co.* v. *Com'r.,* 47 Fed. (2) 108 (C. C. A. 5); *Atkins* v. *Com'r.,* 76 Fed. (2) 387 (C. C. A. 5); and *Shoenberg* v. *Com'r.,* 76 Fed. (2) (C. C. A. 8)."

There is nothing in the record here to indicate an agency on the part of the stockholders.

In *S. B. McMaster, Inc.* v. *Chevrolet Motor Co.*, 3 Fed. (2d) 469, 474 (District Court, E. D. South Carolina, January 6, 1925), after reviewing various definitions of agency, stated as follows:

> "Without undertaking to review in detail all the various definitions that have been made of the term, I think it may safely be asserted that they all recognize two distinctly essential elements. The first is that *the agent is a representative and acts, not for himself, but for another.* The second is that *his acts* within the scope of his authority *must be binding upon his principal.*"

It is submitted that in this case the essential elements of agency are lacking in that it has not been shown or indicated in any way that after the distribution of the stock to the stockholders they acted, in making the sale, not for themselves but for the corporation; and secondly, it has not been shown that the acts of the stockholders were in any way binding upon the corporation.

In the absence of facts to indicate that the stockholders did not gain dominion over the property transferred or acted as trustee or agent of the corporation, sales and transfers between corporations and their stockholders have been upheld as *bona fide.*

See:

Fruit Belt Telephone Co., supra;
G. C. M. 714, V-2 C. B., page 72, 1926;
Taplin v. *Commissioner of Internal Revenue,* 41 Fed. (2d) 454;
Motter v. *Patterson,* 68 Fed. (2d) 252;
Helvering v. *Ackerman,* 71 Fed. (2d) 586;
U. S. v. *D., L. & W. R. R. Co.,* 238 U. S. 516.

Even though the motive for the transfer in this case was the avoidance of taxation, it does not establish liability for tax so long as the transaction is *bona fide* and that the pur-

pose of the parties was to do what they purported to do. There can be no question in this case but that the purpose was to distribute a dividend in kind to the stockholders prior to the sale of the property in question, a perfectly legal and permissible act on the part of the corporation, and this purpose was in every respect carried out.

The corporation parted absolutely with the title to the stock and the stockholders acquired title free of restriction. *George H. Chisholm, petitioner,* v. *Commissioner of Internal Revenue, supra; Gregory* v. *Helvering,* 293 U. S. 465.

It is manifestly inconsistent to hold, as did the Court below, that the petitioner declared and distributed a dividend of stock in kind which gave the stockholders a vested right in the property the subject of the dividend, and at the same time hold that the sale of such stock by the stockholders should be attributed to the corporation through an agency or otherwise.

III.

Conclusion.

Both questions should be answered in the negative and the judgment of the Circuit Court of Appeals should be reversed and decision of the United States Board of Tax Appeals affirmed.

Dated, November 12, 1935.

RUSSELL D. MORRILL,
Amicus Curiae.

WALTER S. ORR,
FRANCIS L. CASEY,
WHITE & CASE,
Of Counsel.

APPENDIX.

Revenue Act of 1928, c. 852, 45 Stat. 791, 797, 799, 800, 815, 816, 818, 822.

Sec. 22. *Gross Income.*

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

Sec. 23. *Deductions from Gross Income.*

In computing net income there shall be allowed as deductions:

• • •

(e) *Losses by Individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or

(3) of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty, or from theft.

(f) *Losses by Corporations.*—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

Sec. 111. *Determination of Amount of Gain or Loss.*

(a) *Computation of Gain or Loss.*—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.

* * *

(c) *Amount Realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

Sec. 113. *Basis for Determining Gain or Loss.*

(a) *Property Acquired After February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; * * *.

Sec. 115. *Distributions by Corporations.*

(a) *Definition of Dividend.*—The term "dividend" when used in this title (except in section 203 (a) (4) and section 208 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913.

(b) *Source of Distributions.*—For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the basis of the stock provided in section 113.

SUPREME COURT OF THE UNITED STATES.

No. 41.—October Term, 1935.

General Utilities and Operating Company, Petitioner, *vs.* Guy T. Helvering, Commissioner of Internal Revenue.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Fourth Circuit.

[December 9, 1935.]

Mr. Justice McReynolds delivered the opinion of the Court.

January 1st, 1927, petitioner—General Utilities, a Delaware corporation—acquired 20,000 shares (one-half of total outstanding) common stock Islands Edison Company, for which it paid $2,000. Gillet & Company owned the remainder.

During January, 1928, Whetstone, President of Southern Cities Utilities Company, contemplated acquisition by his company of all Islands Edison common stock. He discussed the matter with Lucas, petitioner's president, also with Gillet & Company. The latter concern agreed to sell its holdings upon terms acceptable to all. But Lucas pointed out that the shares which his company held could only be purchased after distribution of them among stockholders, since a sale by it would subject the realized profit to taxation, and when the proceeds passed to the stockholders there would be further exaction. Lucas had no power to sell, but he, Gillet and Whetstone were in accord concerning the terms and conditions under which purchase of all the stock might become possible—"it being understood and agreed between them that petitioner would make distribution of the stock of the Islands Edison Company to its stockholders and that counsel would prepare a written agreement embodying the terms and conditions of the said sale, agreement to be submitted for approval to the stockholders of the Islands Edison Company after the distribution of said stock by the petitioner."

Petitioner's directors, March 22, 1928, considered the disposition of the Island Edison shares. Officers reported they were worth $1,122,500, and recommended an appreciation on the books to that

figure. Thereupon a resolution directed this change; also "that a dividend in the amount of $1,071,426.25 be and it is hereby declared on the Common Stock of this Company payable in Common Stock of The Islands Edison Company at a valuation of $56.12½ a share, out of the surplus of the Company arising from the appreciation in the value of the Common Stock of The Islands Edison Company held by this Company, viz, $1,120,500.00, the payment of the dividend to be made by the delivery to the stockholders of this Company, pro rata, of certificates for the Common Stock of The Islands Edison Company held by this Company at the rate of two shares of such stock for each share of Company Stock of this Corporation."

Accordingly, 19,090 shares were distributed amongst petitioner's thirty-three stockholders and proper transfers to them were made upon the issuing corporation's books. It retained 910 shares.

After this transfer, all holders of Islands Edison stock, sold to Southern Cities Utilities Company at $56.12½ per share. Petitioner realized $46,346.30 net profit on 910 shares and this was duly returned for taxation. There was no report of gain upon the 19,090 shares distributed to stockholders.

The Commissioner of Internal Revenue declared a taxable gain upon distribution of the stock in payment of the dividend declared March 22nd, and made the questioned deficiency assessment. Seeking redetermination by the Board of Tax Appeals, petitioner alleged, "The Commissioner of Internal Revenue has erroneously held that the petitioner corporation made a profit of $1,069,517.25 by distributing to its own stockholders certain capital stock of another corporation which it had theretofore owned." And it asked a ruling that no taxable gain resulted from the appreciation upon its books and subsequent distribution of the shares. Answering, the Commissioner denied that his action was erroneous, but advanced no new basis of support. A stipulation concerning the facts followed; and upon this and the pleadings, the Board heard the cause.

It found "The respondent has determined a deficiency in income tax in the amount of $128,342.07 for the calendar year 1928. The only question presented in this proceeding for redetermination is whether petitioner realized taxable gain in declaring a dividend and paying it in the stock of another company at an

agreed value per share, which value was in excess of the cost of the stock to petitioner." Also, "On March 26, 1928, the stockholders of the Islands Edison Company (one of which was petitioner, owning 910 shares) and the Southern Cities Utilities Company, entered into a written contract of sale of the Islands Edison Company stock. At no time did petitioner agree with Whetstone or the Southern Cities Utilities Company, verbally or in writing, to make sale to him or to the Southern Cities Utilities Company of any of said stock except the aforesaid 910 shares of the Islands Edison Company."

The opinion recites—The Commissioner's "theory is that upon the declaration of the dividend on March 22, 1928, petitioner became indebted to its stockholders in the amount of $1,071,426.25, and that the discharge of that liability by the delivery of property costing less than the amount of the debt constituted income, citing *Kirby Lumber Co.* v. *United States*, 284 U. S. 1." "The intent of the directors of petitioner was to declare a dividend payable in Islands Edison stock; their intent was expressed in that way in the resolution formally adopted; and the dividend was paid in the way intended and declared. We so construe the transaction, and on authority of *First Utah Savings Bank, supra* [53 Fed. (2d) 919], we hold that the declaration and payment of the dividend resulted in no taxable income."

The Commissioner asked the Circuit Court of Appeals, 4th Circuit, to review the Board's determination. He alleged, "The only question to be decided is whether the petitioner [taxpayer] realized taxable income in declaring a dividend and paying it in stock of another company at an agreed value per share, which value was in excess of the cost of the stock."

The court stated: "There are two grounds upon which the petitioner urges that the action of the Board of Tax Appeals was wrong: First, that the dividend declared was in effect a cash dividend and that the respondent realized a taxable income by the distribution of the Islands Edison Company stock to its stockholders equal to the difference between the amount of the dividend declared and the cost of the stock; second, that the sale made of the Islands Edison Company stock was in reality a sale by the respondent (with all the terms agreed upon before the declaration of the dividend), through its stockholders who were virtually acting as agents of the respondent, the real vendor."

Upon the first ground, it sustained the Board. Concerning the second, it held that, although not raised before the Board, the point should be ruled upon. "When we come to consider the sale of the stock of the Islands Edison Company we cannot escape the conclusion that the transaction was deliberately planned and carried out for the sole purpose of escaping taxation. The purchaser was found by the officers of the respondent; the exact terms of the sale as finally consummated were agreed to by the same officers; the purchaser of the stock stated that the delivery of all the stock was essential and that the delivery of a part thereof would not suffice; the details were worked out for the express and admitted purpose of avoiding the payment of the tax and for the reason that the attorneys for the respondent had advised that unless some such plan was adopted the tax would have to be paid; and a written agreement was to be prepared by counsel for the respondent which was to be submitted to the stockholders; all this without the stockholders, or any of them, who were ostensibly making the sale, being informed, advised or consulted. Such admitted facts plainly constituted a plan, not to use the harsher terms of scheme, artifice or conspiracy, to evade the payment of the tax. For the purposes of this decision it is not necessary to consider whether such a course as is here shown constituted a fraud, it is sufficient if we conclude that the object was to evade the payment of a tax justly due the government.

"The sale of the stock in question was, in substance, made by the respondent company, through the stockholders as agents or conduits through whom the transfer of the title was effected. The stockholders, even in their character as agents, had little or no option in the matter and in no sense exercised any independent judgment. They automatically ratified the agreement prepared and submitted to them."

A judgment of reversal followed.

Both tribunals below rightly decided that petitioner derived no taxable gain from the distribution among its stockholders of the Islands Edison shares as a dividend. This was no sale; assets were not used to discharge indebtedness.

The second ground of objection, although sustained by the court, was not presented to or ruled upon by the Board. The petition for review relied wholly upon the first point; and, in the circum-

stances, we think the court should have considered no other. Always a taxpayer is entitled to know with fair certainty the basis of the claim against him. Stipulations concerning facts and any other evidence properly are accommodated to issues adequately raised.

Recently (April, 1935) this court pointed out—"The Court of Appeals is without power on review of proceedings of the Board of Tax Appeals to make any findings of fact." "The function of the court is to decide whether the correct rule of law was applied to the facts found; and whether there was substantial evidence before the Board to support the findings made." "If the Board has failed to make an essential finding and the record on review is insufficient to provide the basis for a final determination, the proper procedure is to remand the case for further proceedings before the Board." "And the same procedure is appropriate even when the findings omitted by the Board might be supplied from examination of the record." *Helvering* v. *Rankin*, 295 U. S. 123, 131, 132.

Here the court undertook to decide a question not properly raised. Also it made an inference of fact directly in conflict with the stipulation of the parties and the findings, for which we think the record affords no support whatever. To remand the cause for further findings would be futile. The Board could not properly find anything which would assist the Commissioner's cause.

The judgment of the court below must be reversed. The action of the Board of Tax Appeals is approved.

Reversed.

A true copy.

Test:

Clerk, Supreme Court U. S.